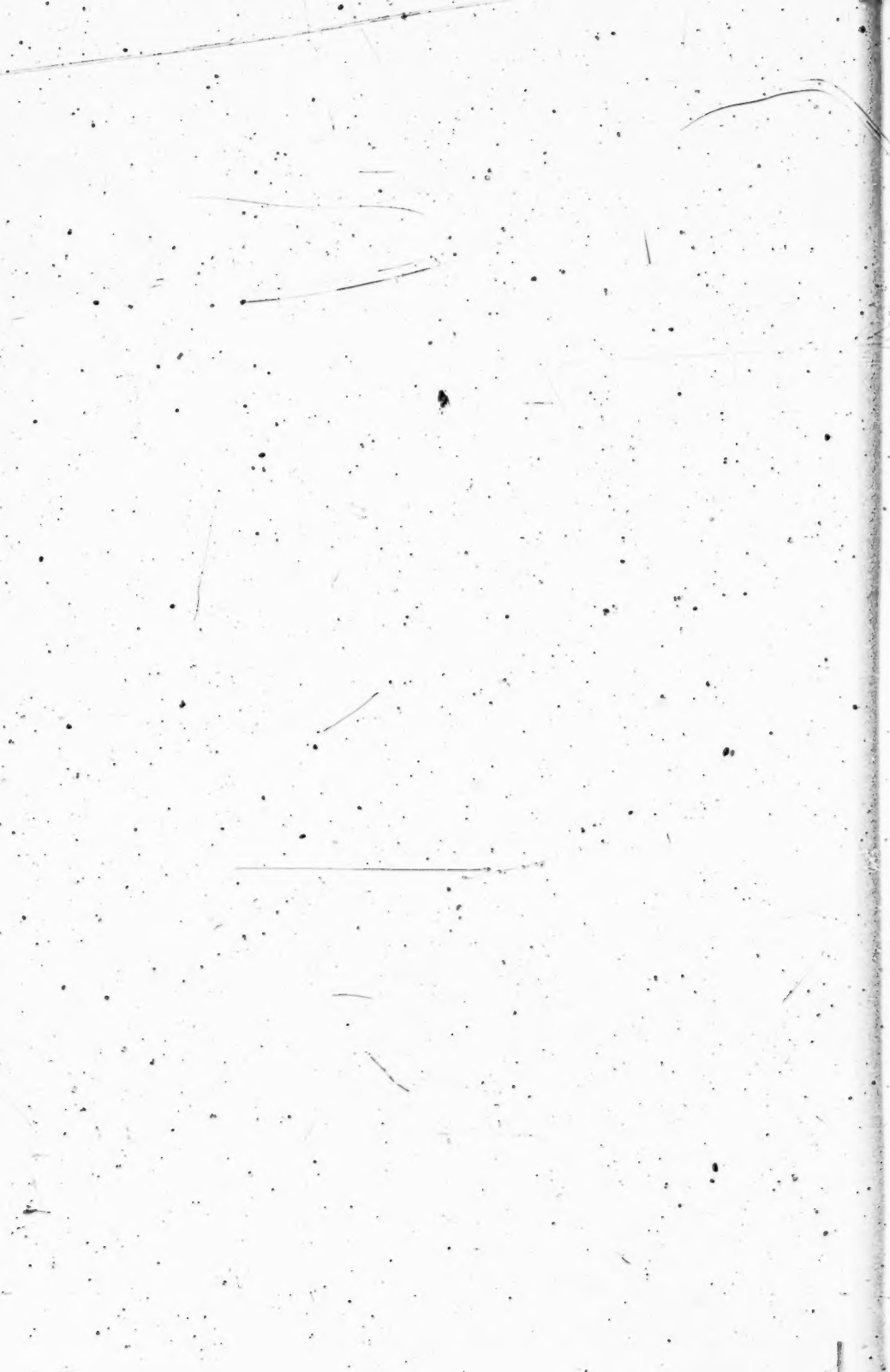


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THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPEARANCES:

For Taxpayer: CAMPBELL E. LOCKE,
DONALD M. DUNN, Esq.,
JOHN L. GRANT, Esq.

For Comm'r: T. H. LEWIS, Esq.,
L. A. SPALDING, Esq.

Docket Entries.

1937

June 1—Petition received and filed. Taxpayer notified.
(Fee paid.)

June 1—Copy of petition served on General Counsel.

July 21—Answer filed by General Counsel.

July 27—Copy of Answer served on taxpayer.

Nov. 27.—Notice issued placing proceeding on New York
City Calendar.

1938

Oct. 18—Hearing set Nov. 28, 1938, New York, N. Y.

Nov. 28—Hearing had before Mr. Murdock on motion of
petitioner to continue to December 12, 1938. Granted
and continued to 12/12/38 at New York City. Peti-
tioner's motion to continue filed.

Dec. 7—Hearing set Dec. 12, 1938, New York City.

Dec. 9—Hearing had before Mr. Disney on motion of
parties to continue—granted—and continued to next
Circuit Calendar.

Docket Entries.

Dec. 9—Order of continuance to the Next New York City Circuit Calendar, entered.

Dec. 15—Hearing set Jan. 9, 1939, New York, N. Y.

1939

Jan. 9—Hearing had before Mr. Hill. On motion of parties to continue this proceeding for 60 days, motion granted, and proceeding continued for 60 days. Said proceeding will remain on the New York Circuit Calendar. Motion for continuance and entry of appearance of Donald M. Dunn filed at hearing.

Mar. 6—Hearing set May 8, 1939 in New York City, N. Y.

Apr. 15—Motion for leave to amend answer, amended answer lodged, filed by General Counsel. 4/17/39 granted.

May 17—Hearing had before Mr. Oppen. Because of delay in preparing complete stipulation of facts, and amended pleadings, Member on own motion continued to New York, N. Y., Calendar of May 22, 1939.

May 17—Order of continuance to the New York, N. Y., Calendar of May 22, 1939, entered.

May 26—Hearing had before Mr. Sternhagen on merits. Submitted. On oral motion of petitioner to consolidate with Docket 93805, granted and consolidated for hearing. Petitioner's motion to file amendments to petition filed and granted. Respondent's motion to file "second amended answer to petition and answer to amendment of petition filed and granted. Petitioner's oral motion to file reply to amended answer and to second amended answer, granted. Stipulation of facts filed. Reply to amended answer filed. Briefs due as per rules.

[2] June 9—Transcript of hearing of May 26, 1939 filed.

June 9—Copy of motion and amended petition served on General Counsel.

June 9—Copy of motion and reply served on General Counsel.

Docket Entries.

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July 6—Motion for extension to Aug. 10, 1939 to file brief, filed by taxpayer. 7/7/39 granted.

July 6—Motion for extension of 30 days to file brief filed by General Counsel. 7/7/39 granted.

Aug. 1—Motion for leave to file amendment of replies, replies lodged, filed by taxpayer.

Aug. 1—Motion for leave to file amendment of petition, amendment lodged, filed by taxpayer.

Aug. 4—Hearing set Aug. 23, 1939 on motion.

Aug. 5—Copy of motion and notice of hearing served on General Counsel.

Aug. 8—Answer to amendments of petition as heretofore amended (dated July 1939), filed by General Counsel.

Aug. 9—Brief filed by taxpayer.

Aug. 9—Motion that answers to the amendments of petition stand as answers to the second amended petitions, filed by General Counsel.

Aug. 9—Motion that supplementary stipulation of facts be received and filed as part of the evidence filed by General Counsel. Supplementary stipulation of facts filed. 8/10/39 granted.

Aug. 10—Motion for leave to file the attached brief, brief lodged, filed by General Counsel. 8/11/39 granted.

Aug. 12—Copy of brief served on General Counsel.

Aug. 14—Proposed findings of fact filed by taxpayer. 8/15/39 copy served on General Counsel.

Aug. 16—Motion for extension to Sept. 18, 1939 to file reply brief, filed by taxpayer. 8/17/39 granted.

Aug. 21—Motion of Aug. 1, 1939 to file amendment of replies, granted, consented to by General Counsel.

Aug. 21—Motion of Aug. 1, 1939 to file amendments of petition granted. Consented to by General Counsel.

Aug. 21—Motion of 8/9/39 for continuance—granted to 9/18/39.

Aug. 22—Copy of motion and amendment to petition served on General Counsel.

8

9

*Docket Entries.***1941**

Jan. 8—Motion for leave to file the attached supplementary brief filed by taxpayer. 1/9/41 granted.

Jan. 9—Supplemental brief filed by taxpayer.

Jan. 9—Copy of motion and supplemental brief served on General Counsel.

Apr. 11—Notice of appearance of John L. Grant as counsel for taxpayer filed.

Apr. 29—Opinion rendered, Smith, Div. 5. Decision will be entered under Rule 50. 4/30/41 copies served.

11 [3] July 5—Computation of deficiency filed by General Counsel.

July 9—Hearing set July 23, 1941 on settlement.

July 16—Consent to settlement filed by taxpayer.

July 17—Decision entered. Arundell, Div. 7.

Oct. 7—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.

Oct. 16—Proof of service filed by taxpayer.

Oct. 24—Proof of service filed.

Nov. 18—Order enlarging time to Feb. 4, 1942 to prepare and deliver the record, entered.

12 Nov. 25—Praecipe for record filed by taxpayer—with proof of service thereon.

[4]

13

UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

VS.

Docket No.
89294.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

14

Petition.

The above named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated March 6, 1937 and for a determination of the petitioner's over-payment of tax in respect of the taxable year involved, and as a basis of its proceeding alleges as follows:

1. The petitioner (hereinafter called the taxpayer), is a life insurance company. It is a corporation organized and existing under the laws of the State of New York, with its principal office at 393 Seventh Avenue, in the Borough of Manhattan, City, County and State of New York.

15

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on March 6, 1937.

3. The taxes in controversy are income taxes for the calendar year 1933 and in the amount of \$428,016.05 plus interest. Deficiencies of \$160,338.66 with interest of \$21,829.57 making a total of \$182,168.23 have been assessed

16

Petition.

and collected. The petitioning taxpayer claims that it is entitled to a refund of \$182,168.23 all of which was paid within two years before the filing of this petition.

[5] 4. The determination of the tax set forth in the said notice of deficiency is based upon the following errors:

17

a. The Commissioner erred in failing to allow a deduction in the amount of \$19,947.50 being a $3\frac{3}{4}\%$ of the mean of the funds held by the taxpayer at the beginning and end of the taxable year as its reserve called "unearned premiums" listed in the Accident and Health Supplements to its annual statements; the maintenance of this reserve being required by the laws of the states in which the taxpayer was then doing business, and the funds so held being "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1932.

18

b. The Commissioner erred in failing to allow a deduction in the amount of \$59,677.67 being a $3\frac{3}{4}\%$ of the mean of the funds held by the taxpayer at the beginning and end of the taxable year as its reserve called "Additional reserve on non-cancellable accident and health policies" listed in the Accident and Health Supplements to its annual statements; the maintenance of this reserve being required by the laws of the states in which the taxpayer was then doing business, and the funds so held being "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1932.

c. The Commissioner erred in failing to allow deduction in the amount of \$144,371.43 being $3\frac{3}{4}\%$ of the mean of [6] the funds held by the taxpayer at the beginning and end of the taxable year as that part of its reserve called "Unpaid and unresisted claims" listed in the Accident and Health Supple-

ments to its annual statements which was held in respect of contingent obligations; the maintenance of this reserve being required by the laws of the states in which the taxpayer was then doing business, and the funds so held being "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1932.

d. The Commissioner erred in failing to allow a deduction in the amount of \$1,746,851.83 being $3\frac{3}{4}\%$ of the mean of the funds held by the taxpayer at the beginning and end of the taxable year as its reserve called "Present value of amounts incurred but not yet due for total and permanent disability benefits less reinsurance" listed as item 9, page 5 of its annual statements; the maintenance of this reserve being required by the laws of the states in which the taxpayer was then doing business, and the funds so held being "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1932. 20

e. The Commissioner erred in failing to allow a deduction in the amount of \$1,516,477.58 being $3\frac{3}{4}\%$ of the mean of the funds held by the taxpayer at the beginning and end of the taxable year as its reserve called "Present [7] value of amounts not yet due on supplementary contracts not involving life contingencies, computed by the Society excluding disability claims included in item 9" listed as item 10, page 5 of its annual statements; the maintenance of this reserve being required by the laws of the states in which the taxpayer was then doing business, and the funds so held being "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1932. 21

f. The Commissioner erred in failing to allow a deduction in the amount of \$211,998.99 being $3\frac{3}{4}\%$

Petition.

of the mean of the funds held by the taxpayer at the beginning and end of the taxable year as its reserve called "Gross premiums paid in advance, including surrender values so applied, less discount, if any" listed as item 21, page 5, of its annual statements; the maintenance of this reserve being required by the laws of the states in which the taxpayer was then doing business, and the funds so held being "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1932.

g. The Commissioner erred in failing to allow a deduction provided by section 203 (a) (8) of the Act, in the amount of \$706,249.82 being the interest which accrued on the taxpayer's supplementary contracts during the taxable year in excess of the guaranteed rate and which was paid by the taxpayer during the taxable year.

[8]

h. The Commissioner erred in failing to allow a deduction provided by section 203 (a) (8) of the Act, in the amount of \$13,432.49 being interest which had accrued prior to the taxable year at the guaranteed rate, on the taxpayer's supplementary contracts and which was paid by the taxpayer during the taxable year.

i. The Commissioner erred in failing to allow a deduction provided by section 203 (a) (8) of the Act, in the amount of \$4,525.68 listed as the last item under "Disbursements" in the Accident and Health Supplement to the taxpayer's annual statement, and being interest which had accrued on the taxpayer's indebtedness for premiums paid in advance by Accident and Health policyholders, and which was paid by the taxpayer during the taxable year.

j. The Commissioner erred in failing to allow a deduction provided by section 203 (a) (7) of the Act,

Petition.

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in the amount of \$222,740.00 (listed in item 34 (b) page 3 of the taxpayer's annual statements) this being the amount of a reasonable allowance for the year for the exhaustion of the taxpayer's property in bonds which the taxpayer had purchased at premiums.

k. The Commissioner erred in failing to allow a deduction provided by section 203 (a) (7) of the Act, in the amount of \$10,747.59 this being the amount of a reasonable allowance for the year for the depreciation of the taxpayer's home office building in respect of the [9] architects' and engineers' fees and other capitalized expenses paid by the taxpayer in the construction of that building.

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l. The Commissioner erred in failing to allow a deduction provided by section 203 (a) (5) of the Act, for investment expenses in the amount of \$422,745.25 this being the sum of defaulted interest included in the prices bid by the taxpayer during the taxable year for properties, over and above the values of the respective properties, which the taxpayer foreclosed that year in states where local laws provided for redemption upon payment of the bid price, and which was included in such bid prices solely for the purpose of insuring the taxpayer against those further losses it would in all probability have suffered on the aggregate investments it had made in loans on these properties, had it bid only the market values of the respective properties.

27

m. The Commissioner erred in failing to allow a deduction in the amount of \$40,000 provided by section 203 (a) (5) (6) and (7) of the Act in respect of fire insurance covering certain real estate then owned by the taxpayer.

Petition.

n. The Commissioner erred in failing to allow a deduction provided by section 203 (a) (7) of the Act in the amount of \$202,730 this being the amount of a reasonable allowance for the taxable year 1933 for the depreciation of the buildings and improvements on the farms then owned by the taxpayer.

[10] 5. The facts upon which the petitioning taxpayer relies as the basis of this proceeding are as follows:

GENERAL FACTS

a. The taxpayer is a corporation duly organized and existing under and by virtue of the laws of the State of New York. It commenced business in that State in the year 1859 as a stock life insurance company and was converted under the Insurance Law of New York to a mutual life insurance company in the year 1925. From the year 1859 continuously to the present time, the taxpayer has been duly authorized to transact the business of life insurance and other kinds of insurance in the State of New York and has been transacting such business in that State pursuant to the laws thereof.

b. From some time prior to the taxable year 1933 continuously to the present time, the taxpayer has been duly authorized in every State of the United States, except Texas, to transact business of issuing life insurance and annuity contract and has been transacting that business in each such State pursuant to the laws thereof. During this entire time more than fifty per centum of the taxpayer's total reserve funds have been held for the fulfillment of its life insurance and annuity contracts.

c. From some time prior to the taxable year 1933, continuously to the present time the Insurance Law of the State [11] of New York, being Chapter 35 of

Petition.

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the Laws of 1909 of said State as amended has provided among other things that there shall be a separate and distinct department charged with the execution of the laws relating to insurance, to be known as the Insurance Department, the chief officer of which shall be the Superintendent of Insurance (hereinafter called the Superintendent).

d. From some time prior to the taxable year 1933, continuously to the present time Section 103 of said Insurance Law has provided among other things that every life insurance corporation doing business in the State of New York shall make an annual report to the Superintendent on printed forms caused to be prepared and furnished by him and that this report shall contain a complete statement of certain matters. 32

e. For the taxable year 1933 and for the preceding taxable year the taxpayer made annual reports (herein called annual statements) to the Superintendent upon blanks which were furnished by him and which were in the form adopted for life insurance companies by the National Convention of Insurance Commissioners. 33

FACTS RELATING PARTICULARLY TO ERRORS 4 a, b, AND c.

f. During and prior to the calendar year 1933, the taxpayer issued accident and health policies insuring the holders thereof against loss from bodily injuries effected through external, violent and accidental [12] means, and against disability from disease. Certain of these policies outstanding during the calendar year 1933 were non-cancellable. For the fulfillment of its obligations in respect of these policies the taxpayer maintained throughout the taxable year 1933 and prior thereto, reserve funds accumulated at interest from premiums. The amounts

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Petition.

of these reserve funds held by the taxpayer at the beginning and end of the taxable year in respect of contingent obligations were as follows:

	<i>Beginning of Year</i>	<i>End of Year</i>
Unearned premiums . . .	\$ 547,648.51	\$ 516,218.34
Unpaid and unresisted Claims	3,771,600.00	4,783,746.00
Additional Reserve on Non-cancellable policies	1,593,248.00	1,589,561.00

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g. Each of these reserve funds, as maintained with annual interest increments, was necessary to meet the obligations for which it was held, and was required by the statutes of the states in which the taxpayer was doing business and by the rulings of state officials made pursuant to authority conferred by those statutes. All of these funds were "reserve funds required by law within the meaning of section 203 (a) (2) of the Revenue Act of 1932. The deductions in respect of these reserve funds provided by that section of $3\frac{3}{4}\%$ of the means of the amounts held at the beginning and end of the taxable year are as follows:

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<i>[13] Reserve</i>	<i>Deduction provided by sec. 203 (a) (2)</i>
Reserve for Unearned A & H premiums	\$ 19,947.50
Reserve for unpaid and unresisted A & H claims	144,371.43
Additional Reserve on non-cancell- able A & H policies	59,677.67

The Commissioner, in computing the tax which the taxpayer here petitions to have redetermined,

allowed no deduction in respect of these or any other reserve held by the taxpayer for the fulfillment of its obligations in respect of its accident and health business.

FACTS RELATING PARTICULARLY TO ERRORS 4 d, e AND f.

h. For the fulfillment of its obligations in respect of certain provisions in its policies known as "total and permanent disability provisions", the taxpayer maintained throughout the taxable year 1933 and prior thereto a fund accumulated at interest from premiums for its reserve called "Present value of amounts incurred but not yet due for total and permanent disability benefits, less reinsurance" (Annual Statements, page 5, Item 9). This reserve fund was maintained and held to meet the payment of contingent benefits which might become due in the future in respect of disabilities which had already commenced.

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i. For the fulfillment of its obligations in respect of its policy provisions known as "Supplementary Contracts [14] not involving life contingencies" the taxpayer maintained throughout the taxable year 1933 and prior thereto a fund accumulated at interest from premiums for its reserve known as "Present value of amounts not yet due on Supplementary Contracts not involving life contingencies, computed by the Society excluding disability claims included in item 9" (Annual Statements, page 5, item 10). This reserve fund was maintained and held to meet the payments which would become due in the future under these supplementary contract provisions.

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j. For the fulfillment of its policy obligations the taxpayer maintained throughout the taxable year 1933 and prior thereto a fund accumulated at inter-

• *Petition.*

est from premiums paid in advance on its life business for its reserve known as "Gross premiums paid in advance, including surrender values so applied, less discount, if any" (Annual Statements, page 5, item 21). This reserve fund was maintained and held as an essential part of the actuarial reserves necessary to meet the payment of future death benefits and other future contingent policy benefits.

k. The amounts of these reserve funds held by the taxpayer at the beginning and end of the taxable year 1933 were as follows:

[15]	<i>Reserve Fund</i>	<i>Beginning of Year</i>	<i>End of Year</i>
	Present value of amounts incurred but not yet due for total and permanent disability benefits, less reinsurance	\$43,643,616.00	\$49,521,615.00
	Present value of amounts not yet due on Supplementary Contracts not involving life contingencies computed by the Society excluding disability claims included in item 9	36,739,376.00	44,139,428.00
	Gross premiums paid in advance, including surrender values so applied, less discount if any	5,120,972.64	6,185,639.99

l. Each of these reserve funds, as maintained with annual interest increments, was necessary to

Petition.

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meet the obligations for which it was held, and was required by the statutes of the states in which the taxpayer was doing business and by the rulings of state officials made pursuant to authority conferred by these statutes. All of these funds are "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1932. The deductions in respect of these reserve funds provided by that section of $3\frac{3}{4}\%$ of the mean of the amounts held at the beginning and end of the taxable year are as follows:

44

Reserve Fund

*Deduction
provided by
sec. 203 (a) (2)*

Present value of amounts incurred but not yet due for total and permanent disability benefits less re-insurance

\$1,746,851.83

[16] Present value of amounts not yet due on Supplementary Contracts not involving life contingencies computed by the Society, excluding disability claims included in item 9.

1,516,477.59

45

Gross premiums paid in advance including surrender values so applied less discount if any

211,998.99

The Commissioner in computing the tax which the taxpayer here petitions to have redetermined, failed to allow the deductions provided by section 203 (a) (2) of the Revenue Act of 1932 in respect of any of these reserve funds.

FACTS RELATING PARTICULARLY TO ERRORS 4 g, h AND i.

m. The policy provisions known as "Supplementary Contracts not involving life contingencies"

Petition.

in force and outstanding throughout the year 1933 and prior thereto, required the taxpayer to pay interest on its indebtedness covered by these provisions at a specified minimum guaranteed rate and also in excess amounts if these excess amounts should be earned. The payment of this interest both at the guaranteed rate and in the excess amounts which might be earned was required not only by the contract provisions themselves but by the statutes of the States in which the petitioner was doing business and by the rulings of State officials made pursuant to the authority conferred by those statutes.

[17]. n. During the taxable year 1933 the taxpayer paid as so required such earned excess interest, which accrued during that year, in the amount of \$706,249.82. The Commissioner, in computing the tax which the taxpayer here petitions to have redetermined, allowed the deduction authorized by section 203 (a) (8) of the Revenue Act of 1932 of \$1,118,594.00 guaranteed interest which, during the taxable year, accrued and was paid by the taxpayer on its indebtedness covered by these "Supplementary contracts not involving life contingencies" but failed to allow the deduction authorized by the same section of the above stated \$706,249.82 earned excess interest which, during the taxable year, accrued and was paid by the taxpayer on this same indebtedness.

o. During the taxable year the taxpayer paid guaranteed interest in the amount of \$13,432.49 which had accrued in prior years on the indebtedness covered by the above mentioned "Supplementary Contracts not involving life contingencies." The Commissioner, in computing the tax which the tax-

Petition.

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payer here petitions to have redetermined, failed to allow any deduction in respect of this \$13,432.49. A deduction of the full amount thereof is authorized by section 203 (a) (8) of the Revenue Act of 1932.

p. During the taxable year and prior thereto the taxpayer had accepted funds from certain accident and health [18] policyholders agreeing with each such policyholder that such funds accepted from him would be held on demand, supplemented with interest, and applied in payment of premiums subsequently becoming due on his policy. During the taxable year, in accordance with such agreements, the taxpayer supplemented such funds with interest in the amount of \$4,525.68 and applied such supplemented funds including that interest in payment of such premiums. The Commissioner, in computing the tax which the taxpayer here petitions to have redetermined, failed to allow any deduction in respect of this \$4,525.68. A deduction of the full amount thereof is authorized by section 203 (a) (8) of the Revenue Act of 1932.

50

FACTS RELATING PARTICULARLY TO ERRORS 4 j AND k.

51

q. During the taxable year and prior thereto the taxpayer purchased certain bonds at prices in excess of par. The premium or amount in excess of par paid by the taxpayer for each of these bonds was the reasonable value at the time of the purchase, of the interest payable on the bond to its maturity in excess of the rate of interest which similar first grade bonds then being issued had to carry in order to be marketed at par. By adjustment entries in its annual statements (item 34 (b) page 3) the taxpayer decreased its assets each year by the year's portion of each such premium prorated [19] to the

Petition.

maturity of the bond. For the taxable year 1933, the taxpayer's assets were so decreased by \$222,740.00 being the aggregate of that year's portion of such premiums so prorated; and being the amount of a reasonable allowance for the year for the exhaustion of the taxpayer's property in the bonds which it had purchased at premiums. A deduction of the full amount of this exhaustion of the taxpayer's assets is authorized by section 203 (a) (7) of the Revenue Act of 1932. The Commissioner, in computing the tax which the taxpayer here petitions to have redetermined, allowed no deduction in respect of this exhaustion of assets.

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r. Throughout the taxable year 1933 the taxpayer owned and in part occupied its home office building at 393 Seventh Avenue, New York City. As part of the original cost of this building the taxpayer paid architects' and engineers' fees and certain other capitalized expenses in the amount of \$1,651,214.92. A reasonable allowance for the taxable year 1933 for the depreciation of that property in respect of these capitalized expenses, as authorized by section 203 (a) (7) of the Revenue Act of 1932 is \$41,280.37 being $2\frac{1}{2}\%$ of the amount so spent and capitalized. For the taxable year 1933 the rental values of the space in this building not then occupied by the taxpayer was \$407,217.09 and of the entire building \$1,564,078.35. The ratio of these amounts (26.0356%) applied to \$41,280.37 (the reasonable allowance for depreciation in respect of the [20] above mentioned capitalized expenses) is \$10,747.59. In accordance with the provisions of section 203 (a) (7) of the Revenue Act of 1932, as modified by section 203 (b) of that Act, the taxpayer is entitled to a deduction of this \$10,747.59 for deprecia-

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Petition.

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tion of its home office building in respect of the above mentioned capitalized expenses. The Commissioner, in computing the tax which the taxpayer here petitions to have redetermined, allowed no deduction for the depreciation of that building in so far as that building represents these architects' and engineers' fees and the other above mentioned capitalized expenses paid by the taxpayer in its construction.

FACTS RELATING PARTICULARLY TO ERROR 4 I.

s. During the year 1933, the taxpayer foreclosed various mortgages in States where the local laws provided for redemption by the debtor or junior encumbrancer upon payment of the price bid at the foreclosure sale. In bidding in the properties here involved, the taxpayer was faced with the probability of sustaining further losses on the aggregate investments it had made in loans on these properties if it should bid only the market values of the respective properties. The taxpayer, at the foreclosure sales, bid in each property for an amount larger than the defaulted principal of the mortgage plus foreclosure costs. The bids made by the taxpayer were respectively greater than the values [21] of the properties. These excess amounts, over the values of the properties, were bid solely for the purpose of insuring against further loss on the aggregate investments involved. 56

t. The aggregate of the amounts by which the bid prices respectively exceeded the sum of the unpaid principal plus foreclosure costs or the value of the property, whichever was greater, is \$422,745.25. The Commissioner in computing the tax, which the taxpayer here petitions to have redetermined, has included this aggregate in gross income 57

Petition.

58

and has allowed no deduction in respect of it. A deduction of the full amount thereof is provided by section 203 (a) (5) of the Revenue Act of 1932.

59

u. The book value of the invested assets held by the taxpayer was \$1,415,527,735.08 at the beginning of the taxable year and \$1,445,456,222.12 at the end thereof. One-fourth of one per centum of the mean of these amounts is \$3,576,230.00. The total deduction for investment expenses allowed by the Commissioner, under section 203 (a) (5) of the Revenue Act of 1932, in computing the taxes which the taxpayer here seeks to have redetermined, amounted to \$2,606,147.72.

FACTS RELATING PARTICULARLY TO ERROR 4 m.

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v. During the taxable year 1933 and prior thereto the taxpayer acquired various properties by foreclosure of mortgages which it held or by accepting deeds in lieu [22] of such foreclosure. Prior to such acquisition the taxpayer had paid the premiums on fire insurance policies covering the properties for 1933 and subsequent years. These premiums were paid for the account of the taxpayer's borrowers who then owned the properties. The amounts of such premiums were added to the debts owed to the taxpayer and secured by mortgages held by the taxpayer. The amounts paid by the taxpayer for the acquisition of these properties included the cost of such fire insurance coverage. The cost, so included and paid by the taxpayer, for such coverage for that part of 1933 during which the taxpayer owned these respective properties, amounted to \$40,000. The cost so included and paid by the taxpayer in 1933, for such coverage for that part of 1933 and subsequent years during which the tax-

Petition.

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payer owned these respective properties, was in excess of \$40,000. The Commissioner in computing the taxes which the taxpayer here petitions to have redetermined, failed to allow any deduction for the amounts paid by the taxpayer for this fire insurance coverage, or for the exhaustion of such coverage which occurred during the taxable year 1933. A deduction of at least \$40,000 for the amounts paid by the taxpayer for this coverage or for such exhaustion of the coverage is provided by section 203 (a) (5) (6) and (7) of the Revenue Act of 1932.

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[23] **FACTS RELATING PARTICULARLY TO ERROR 4 D.**

w. During the taxable year 1933 the taxpayer owned a large number of farms improved by houses, barns, silos, cribs, sheds, pens, and other farm buildings, all acquired by the taxpayer subsequent to the year 1913. These improvements were acquired by the taxpayer at a cost of \$4,054,000. A reasonable allowance for the depreciation of these improvements while owned by the taxpayer during the year 1933, as provided by section 203 (a) (7) of the Revenue Act of 1932 is \$202,730. The Commissioner, in computing the taxes which the taxpayer here petitions to have redetermined, allowed no deduction for the depreciation of these improvements.

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RES ADJUDICATA.

x. Except for the amounts involved, the issues presented in Assigned Errors 4 b and c are res adjudicata having been decided in the taxpayer's favor by the decision of the Board of Tax Appeals promulgated December 12, 1935 in the case of The Equitable Life Assurance Society of the United

Petition.

States v. Commissioner 33 B. T. A. 708. No appeal from that decision was taken and that decision has become final. The reserves, in respect of which deductions are here claimed by the taxpayer in assigned errors 4 b and c of this petition, are the same reserves, computed in the same manner, held for the same purposes, primarily for the identical policies and otherwise for exactly similar policies, and are required by the same laws as the reserves involved in that case. The provisions of section [24] 203 (a) (2) of the Revenue Act of 1932 which provide the deductions for these reserves claimed in this petition, are, in so far as the taxpayer's right to the deductions is concerned, the same as the provisions of the Revenue Acts which were involved in that case.

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y. Except for the amount involved, the issues presented in assigned error 4 d are res adjudicata having been decided in the taxpayer's favor by the above cited decision of the Board of Tax Appeals from which no appeal was taken and which has become final. The taxpayer's right to a deduction in respect of this reserve was not disputed in that case but this right is determined by the same issues there decided.

66

WHEREFORE, the petitioning taxpayer prays that this Board may hear this proceeding and

1. redetermine the deficiency asserted by the Commissioner for the taxable year 1933;

2. redetermine the petitioner's income taxes for such taxable year free from the errors assigned herein;

3. determine the amount of overpayments of tax made by the petitioner in respect of the taxable year 1933 and

Petition.

67

that such overpayments were made within two years before the filing of this petition; and

4. grant to the petitioner such other and further relief as may appear to this Board to be just and proper in the premises.

CAMPBELL E. LOCKE,
Counsel for the Petitioner,
120 Broadway,
New York, N. Y.

68

[25]

State of New York, }
County of New York, } ss.:

ANDREW E. TUCK, being duly sworn, says that he is a Vice-President of The Equitable Life Assurance Society of the United States, the petitioner above named, and as such is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein, and that the facts stated are true.

ANDREW E. TUCK.

69

Subscribed and sworn to before me
on this 28th day of May 1937.

HENRY M. ENSOR,
Notary Public, Bronx County No. 30, Reg. No. 25-E-39.
Cert. filed in N. Y. Co. No. 155, Reg. No. 9-E-108.
Commission Expires March 30, 1939.
(Seal)

70 [26]

Exhibit "A."**TREASURY DEPARTMENT****WASHINGTON**

**Office of
Commissioner of Internal Revenue**

**Address Reply to
Commissioner of Internal Revenue
And Refer To**

March 6, 1937.

71

**The Equitable Life Assurance Society
of the United States,
393 Seventh Avenue,
New York, New York.**

Sirs:

You are advised that the determination of your income tax liability for the taxable year(s) 1933 discloses a deficiency of \$267,677.39 as shown in the statement attached.

72

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest

Exhibit "A."

73

period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By W. T. SHERWOOD,
Deputy Commissioner.

Enclosures:
Statement
Form 870
Schedules 1 and 2

74

[27]

STATEMENT.

IT:A:6

JHP:90D.

In re: The Equitable Life Assurance Society
of the United States
393 Seventh Avenue,
New York, New York.

75

Income Tax Liability

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1933	\$428,016.05	\$160,338.66	\$267,677.39

The deficiency shown herein is based upon the reports dated January 28, 1936 and March 13, 1936, prepared by Internal Revenue Agent F. Newton and transmitted to you under dates of January 30, 1936 and March 20, 1936 and upon such adjustments as are shown in the attached schedules numbered 1 and 2.

76

Exhibit "A."

In arriving at the above result careful consideration has been given to the additional information contained in your memorandum submitted by the internal revenue agent in charge, 807 United States Post Office Building, New York, New York, under date of June 17, 1936 relative to reserve items set forth on page 5, items 9 and 11 of the annual statement for the year 1933 and at a conference held in Washington, D. C., on October 29, 1936 and, also, to the additional information submitted by the above-mentioned internal revenue agent in charge under date of January 23, 1937, relative to the amount paid in the year 1933 for repairs and renovations for the purpose of placing properties acquired through foreclosure proceedings in a rentable condition.

77

[28] The Equitable Life Assurance Society
of the United States

Year ended December 31, 1933.

SCHEDULE 1

Adjustments to Net Income

78

Net loss as disclosed by return	\$ 443,336.52
As corrected—Net income	3,157,461.74

Net adjustment as computed below—Addition to income	\$3,600,798.26
---	----------------

Unallowable deductions and additional income:

(a) Depreciation on permanent equipment and furniture and fixtures	\$ 254,965.00
(b) Accrued interest on foreclosed mortgages..	680,650.85

Exhibit "A."

79

(c) 3¾% of mean reserve funds overstated	3,447,563.12	
(d) Interest on premiums paid in advance	4,525.68	
(e) Capital expenditures included in repairs and expenses	336,738.89	
Total		\$4,724,443.34

Non-taxable income and additional deductions: 80

(f) Interest paid supplementary contracts	\$1,118,594.00	
(g) Depreciation — Capital expenditures	5,051.08	
Total		1,123,645.08

Net adjustment as above—Addition to income **\$3,600,798.26**

[29] SCHEDULE 1-A.

Explanation of Items

81

(a) Gross income, page 2 annual statement **\$353,060,941.30**

Less: Annual statement, page 2:

Line 9—Consideration for supplementary contracts involving life contingencies **\$2,396,784.57**

Line 9A—Consideration for disability claims. **89,128.49**

82

Exhibit "A."

	Line 10—Consideration for supplementary con- tracts not involv- ing life contin- gencies	15,044,699.53	
	Line 11—Dividends left with company ...	3,587,293.24	
	Line 11A—Interest divi- dend deposits	473,817.78	
	Line 20—Rent own occu- pancy	1,149,996.26	
83	Line 22(b)—Suspense items	2,157,515.89	24,899,235.76
	Gross income adjusted		\$328,161,705.54
	Gross investment—Income shown on return		\$ 61,172,532.08
	Percentage which gross in- vestment income is of total gross income	18.64%	
	Depreciation taken, schedule 12, return:		
	Pneumatic Tubes	\$ 27,407.00	
	Furniture and fixtures ..	285,972.00	\$ 313,379.00
84	Depreciation allowable, (18.64% of \$313,379.00)		58,414.00
	Excessive depreciation disallowed		\$ 254,965.00

[30] The depreciation allowable has been computed in accordance with the decision of the United States Supreme Court rendered May 21, 1934 in the case of Rockford Life Insurance Company.

(b) Accrued interest on foreclosed mortgages constitutes taxable income when mortgagee acquires title to property at foreclosure for amount equal to loans, costs and interest in accordance with the decision of the United

Exhibit "A."

85

States Supreme Court rendered February 15, 1937 in the case of Midland Mutual Life Insurance Company.

(c) Amended reserves

December 31, 1932 December 31, 1933

Outstanding policies and annuities	\$1,134,759,132.00	\$1,168,581,172.00	
Disability and accidental death benefits	26,664,523.00	29,617,020.00	
	<hr/>	<hr/>	
	\$1,161,423,655.00	\$1,198,198,192.00	86
Mean of the above reserves		\$1,179,810,923.50	
3¾% of mean of the reserve funds allowable		\$ 44,242,909.64	
3¾% of mean of the reserve fund taken on return		47,690,472.76	
		<hr/>	
3¾% of mean of the reserve fund overstated		\$ 3,447,563.12	

In accordance with section 203(a)(2) of the Revenue Act of 1932, you are permitted as a deduction 3¾% of the mean of the reserve funds required by law; therefore, the reserves contemplated by law have been redetermined as shown above.

87

In this connection your attention is invited to the decision rendered by the United States Court of Claims in the case of the Continental Assurance Company and the decision of the United States Supreme Court in the case of Inter-Mountain Life Insurance Company and to article 971 of Regulations 77 as amended by Treasury Decision 4615 published in Internal Revenue Bulletin December 30, 1935, volume XIV, #52, page 17.

[31] (d) Since discounts on premiums do not come within the classification of interest paid as defined in section

Exhibit "A."

203(8) of the Revenue Act of 1932, in accordance with the decision of the United States Board of Tax Appeals in the case of Illinois Life Insurance Company, Docket No. 67201, promulgated June 12, 1934, they are disallowed as a deduction from gross income.

- 89 (e) Cost of improvements to foreclosed properties included in deduction item 11 of return captioned "Other Real Estate Expenses" now disallowed as a deduction from gross income representing expenses of placing properties acquired through foreclosure proceedings in a rentable condition as shown below:

Initial renovation expenses	
General work	\$264,071.91
Shades	4,158.62
Interior decorating	68,508.36
<hr/>	
Capital expenditures restored to income	\$336,738.89

- 90 (f) Interest paid under supplementary contracts allowed as a deduction from gross income in accordance with the decision of the United States Board of Tax Appeals in the case of The Penn Mutual Life Insurance Company, Docket No. 52577 promulgated June 28, 1935.

(g) Depreciation—Improvements—Foreclosed Properties

Year	Cost	Rate	Allowable Depreciation
1933	\$336,738.89	1½% Averaged	\$5,051.08

Allowing depreciation at an annual rate of 3% on capital expenditures restored to taxable income.

The above adjustments (a), (b), part of (c), (d), (e), (f), and (g) were agreed to by you by agreement forms

Exhibit "A."

870 dated January 31, 1936, March 13, 1936, and February 19, 1937.

[32]

SCHEDULE 2

Computation of Tax
Income Tax

Net income for taxable year	\$3,157,461.74	
Income tax at 13 $\frac{3}{4}$ percent	434,150.99	
Less:		
Taxes paid to a foreign country (1)	6,134.94	
	<hr/>	92
Total income tax assessable	\$ 428,016.05	
Total previously assessed:		
February 1936, list-page 2,		
line 2, #3	\$58,642.16	
Collector's #520352/36	56,733.90	
Additional, February 1937,		
page 0, line 8, #4	44,962.60	160,338.66
	<hr/>	<hr/>
Deficiency in tax	\$ 267,677.39	
(1) Proportion of foreign mean reserve		
to total mean reserve	1.41309%	
\$434,150.99 x 1.41309% equals	\$ 6,134.94	93

94 [33]

UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.
89294.

95

Answer.

The Commissioner of Internal Revenue by his attorney, Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Denies all the material allegations contained in paragraph 1 of the petition, except the allegation that the petitioner is a corporation organized and existing under the laws of the State of New York, which allegation is admitted.

96

2. Admits all the material allegations contained in paragraph 2 of the petition.

3. Denies all the material allegations contained in paragraph 3 of the petition, except the allegation that the taxes in controversy are income taxes for the calendar year 1933, which allegation is admitted.

4-(1). Denies that the respondent committed error in the determination of the deficiency as alleged in paragraph 4 of the petition.

4-(2). Denies that any error was made in the determination of the deficiency referred to in deficiency letter dated March 6, 1937.

[34] 5. Denies all the material allegations contained in paragraph 5 of the petition, except the allegation that "The taxpayer is a corporation duly organized and existing under and by virtue of the laws of the State of New York", which allegation is admitted.

6. Denies generally and specifically each and every allegation in the petitioner's petition contained not hereinbefore admitted, qualified or denied. 98

WHEREFORE, it is prayed that the petitioner's appeal be denied.

(Signed) MORRISON SHAFROTH.
MORRISON SHAFROTH,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

J. ARTHUR ADAMS,
FRANK A. SURINE,
Special Attorneys,
Bureau of Internal Revenue.

100 [35]

UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.
89294.

101

Amended Answer to Petition.

The respondent, by his attorney, J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, for an amended answer to the petition filed in this proceeding, admits, denies and avers as follows:

102

1. Denies all the material allegations contained in paragraph 1 of the petition, except the allegation that the petitioner is a corporation organized and existing under the laws of the State of New York, which allegation is admitted.

2. Admits all the material allegations contained in paragraph 2 of the petition.

3. Denies all the material allegations contained in paragraph 3 of the petition, except the allegation that the taxes in controversy are income taxes for the calendar year 1933, which allegation is admitted.

4(a). Denies the Commissioner erred as alleged in subparagraphs a to n, inclusive, of paragraph 4 of the petition.

4(b). Avers the respondent erred in allowing the petitioner to deduct $3\frac{3}{4}$ per cent of the mean of the reserve

funds held by the [36] petitioner during the taxable year to provide payment for disability benefits expected to become due in the future with respect to future disabilities and to provide for additional accidental death benefits.

5. Denies all the material allegations contained in paragraph 5 of the petition, except the allegation that "The taxpayer is a corporation duly organized and existing under and by virtue of the laws of the State of New York," which allegation is admitted.

6(a). The facts relied upon by the respondent in support of the allegations of error as set forth in paragraph 4(b) are as follows:

104

At the beginning of the taxable year 1933, petitioner held, among its reserves, a reserve in the amount of \$19,345,376. At the end of the year this reserve had been increased to \$21,887,167. The purpose of this reserve was to provide for benefits expected to become due in the future in respect to future disabilities occurring as to those life insurance policies issued by the petitioner containing disability provisions. This reserve is not a life insurance reserve and it is wholly separate and distinct from the reserves accumulated with respect to petitioner's life insurance risk. In determining the deficiency herein the respondent allowed the petitioner a deduction in the amount of $3\frac{3}{4}$ per cent of the mean of this reserve for the taxable year 1933.

105

6(b). At the beginning of the taxable year 1933, petitioner also held among its reserves a reserve for accidental death benefits expected to become due in the future in the amount of \$7,319,147 and \$7,729,853 at the end thereof. This reserve was accumulated to provide for accidental death benefits to which certain of the petitioner's policyholders [37] might become entitled under the terms of their

106

Amended Answer to Petition.

policies. This reserve is not a life insurance reserve and it is wholly separate and distinct from the reserves accumulated with respect to the petitioner's life insurance policies. In determining the deficiency herein the respondent allowed the petitioner to deduct $3\frac{3}{4}$ per cent of the mean of this reserve.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

107.

WHEREFORE, it is prayed that the petitioner's appeal be denied and that the deficiency be increased in accordance with the affirmative allegations of this amended answer and claim is hereby asserted for such increased deficiency.

J. P. WENCHEL,
ECA.

Chief Counsel,
J. P. WENCHEL,
Bureau of Internal Revenue.

OF COUNSEL:

108 E. O. HANSON,
Division Counsel.
THOS. H. LEWIS, JR.,
LEONARD A. SPALDING, JR.,
Special Attorneys,
Bureau of Internal Revenue.
LAS/lmv 4/10/39

[38]

UNITED STATES BOARD OF TAX APPEALS

109

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

Docket No.
89294.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

110

Amendment of Petition.

The petitioner, The Equitable Life Assurance Society of the United States, with leave of the Board and with the consent of the respondent, amends its petition in the above entitled proceeding, by striking therefrom the following paragraphs:

4(f) and 5(j), both relating to gross premiums paid in advance;

4(j) and 5(q), both relating to premiums paid on bonds;

4(l) and 5(s), all relating to defaulted interest on foreclosed

5(t)

5(u) mortgages;

4(m) and 5(v), both relating to fire insurance premiums;

111

and by changing paragraph 4(d), 5(h), 5(k) and 5(l) to read respectively, as follows:

4(d). The Commissioner erred in failing to allow a deduction in the amount of \$2,165,217.50 being 3¾% of the mean [39] of the funds held by the

112

Amendment of Petition.

taxpayer at the beginning and end of the taxable year as its reserves for total and permanent disability benefits which would probably become due in the future pursuant to the total and permanent disability provisions of its life policies, from disabilities which had already commenced; the maintenance of these reserves being required by the laws of the states in which the taxpayer was then doing business, and the funds so held being "reserve funds required by law." within the meaning of section 203 (a) (2) of the Revenue Act of 1932.

113

5(h). For the fulfillment of its obligations under certain provisions in its policies known as "total and permanent disability provisions," the taxpayer maintained throughout the taxable year 1933 and prior thereto funds accumulated at interest from premiums, for a reserve fund held to provide for contingent benefits expected to become due in the future in respect of disabilities which had already commenced, (generally known as "Reserve for Total and Permanent Disability Benefits, Disable Lives").

114

5(k). The amounts of these reserve funds held by the taxpayer at the beginning and end of the taxable year [40] 1933 were as follows:

<i>Reserve Fund</i>	<i>Beginning of Year</i>	<i>End of Year</i>
Reserve for Total and Permanent Disability Benefits, Disabled Lives	\$54,526,322.01	\$60,951,944.91
Present value of amounts not yet due on Supplementary Con- tracts not involving life contingencies ...	34,806,201.00	42,326,682.00

Amendment of Petition.

115

5(1). Each of these reserve funds, described in paragraphs 5(h), 5(i), and 5(k) of this petition, as maintained with annual interest increments, was necessary to meet the obligations for which it was held, and was required by the statutes of the states in which the taxpayer was doing business and by the rulings of state officials made pursuant to authority conferred by these statutes. All of these funds are "reserve funds required by law" within the meaning of section 203 (a)(2) of the Revenue Act of 1932. The Commissioner in computing the tax which the taxpayer here petitions to have re-determined, failed to allow any deduction in respect of these reserve funds other than the deduction noted in 5(n) hereof of \$1,118,594.00 which was allowed as a deduction for guaranteed interest paid on the taxpayer's Supplementary Contracts not involving life contingencies.

116

(Signed) CAMPBELL E. LOCKE.

CAMPBELL E. LOCKE,
Attorney for Petitioner,

120 Broadway,
New York, N. Y.

117

118

Amendment of Petition.

[41]

State of New York,
 City of New York,
 County of New York, } ss.:

119

ANDREW E. TUCK, being duly sworn, says that he is a Vice-President of The Equitable Life Assurance Society of the United States, the petitioner above named, and as such is duly authorized to verify the foregoing amendment of the petition herein; that he has read the foregoing amendment of the petition and is familiar with the statements contained therein, and that the facts stated are true to the best of his knowledge, information and belief.

(Signed) ANDREW E. TUCK.
 ANDREW E. TUCK.

Subscribed and sworn to before me
 on this 15th day of May, 1939.

(Signed) HENRY M. ENSOR,

HENRY M. ENSOR.

Notary Public, Bronx County No. 33, Reg. No. 20-E-41.

Cert. filed in N. Y. Co. No. 83, Reg. No. 1-E-68.

Commission Expires March 30, 1941.

120

(Seal)

[42]

UNITED STATES BOARD OF TAX APPEALS

121

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.
89294

**Second Amended Answer to Petition and
Answer to Amendment of Petition.**

122

The respondent, by his attorney, J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, for a second amended answer to petition and answer to amendment of petition filed in this proceeding, admits, denies and avers as follows:

1. Admits the petitioner is a corporation organized and existing under the laws of the State of New York with its principal offices at 393 Seventh Avenue, in the Borough of Manhattan, City, County and State of New York. Denies the remaining allegations contained in paragraph 1 of the petition as amended.

123

2. Admits all the material allegations contained in paragraph 2 of the petition as amended.

3. Admits that the taxes in controversy are income taxes for the calendar year 1933 but denies the remaining allegations contained in paragraph 3 of the petition as amended.

124

*Second Amended Answer to Petition and
Answer to Amendment of Petition.*

4(a). Denies that the Commissioner erred as alleged in subparagraphs (a), (b), (c), (d), (e), (g), (h), (i), (k), and (n) of paragraph 4 of the petition as amended.

125

[43] 4(b) Avers that the respondent erred in allowing the petitioner to deduct 3 $\frac{3}{4}$ per cent of the mean of certain liabilities carried on the books of the petitioner during the taxable year 1933 and entitled "Extra Reserve for Total and Permanent Disability Benefits and for Additional Accidental Death Benefits Included in Life Policies."

4(c). Avers that the respondent erred in allowing petitioner to deduct \$1,118,594 as guaranteed interest paid with respect to its "Supplementary Contracts not Involving Life Contingencies."

5. Denies all material allegations contained in paragraph 5 of the petition as amended except the allegation that the "taxpayer" is a corporation duly organized and existing under and by virtue of the laws of the State of New York" which allegation is admitted.

126

6(a). The facts relied upon by the respondent in support of the allegations of error as set forth in paragraph 4(b) are as follows:

At the beginning of the taxable year 1933 the petitioner carried on its books as a liability an item in the amount of \$19,345,376. At the end of the year the petitioner carried on its books as a liability an item in the amount of \$21,887,167. The purpose of these items was to provide for the petitioner's estimated liabilities with respect to disability benefits which were expected to become payable in the future under certain disability provisions contained in certain of the life insurance policies issued by petitioner. The liability was not a life insurance reserve, was in no way connected with the reserves accumulated [44] with

*Second Amended Answer to Petition and
Answer to Amendment of Petition.*

127

respect to petitioner's life insurance risks, and was not a reserve fund required by law within the meaning and intent of section 203 (a)(2) of the Revenue Act of 1932. In determining the deficiency herein the respondent allowed the petitioner a deduction in the amount of $3\frac{3}{4}$ per cent of the mean of this liability.

6(b). At the beginning of the year 1933 the petitioner carried on its books as a liability an item in the amount of \$7,319,147. At the end of the year the petitioner carried on its books as a liability an item in the amount of \$7,729,853. The purpose of these items was to provide for the petitioner's estimated liabilities with respect to accidental death benefits which were expected to become payable in the future under certain accidental death provisions contained in certain of the life insurance policies issued by petitioner. The liability was not a life insurance reserve, was in no way connected with the reserves accumulated with respect to petitioner's life insurance policies, and was not a reserve fund required by law within the meaning and intent of section 203(a)(2) of the Revenue Act of 1932. In determining the deficiency herein, the respondent allowed the petitioner to deduct $3\frac{3}{4}$ per cent of the mean of this liability at the beginning and end of the taxable year 1933.

128

129

6(c). The facts relied upon by the respondent in support of the allegation of error set forth in paragraph 4(c) are as follows:

During and prior to the year 1933 petitioner sold various types of life insurance policies which included provisions permitting the insured to elect with respect to the method of settlement upon the maturity of the policy. In the absence of an election [45-46] by the insured prior to the maturity of the policy, the beneficiary was granted the same privilege. Attached hereto and marked Exhibit A,

130

*Second Amended Answer to Petition and
Answer to Amendment of Petition.*

131

and made a part hereof, is a copy of the various optional modes of settlement provided for in petitioner's policies of life insurance. The sum of \$1,118,594 claimed by the petitioner as a deduction on its return as "guaranteed interest" was accrued and paid by the petitioner with respect to contracts arising out of the exercise of options 1, 2, or 4. The respondent in determining the deficiency herein permitted the petitioner to deduct \$1,118,594 as interest accrued and paid. Of the amount thus allowed as a deduction \$538,984 was accrued and paid with respect to contracts each of which arose out of the exercise by the insured of options 1, 2, or 4 prior to the maturity of the policy and \$579,610 was accrued and paid with respect to contracts which arose out of the exercise by the beneficiary of options 1, 2, or 4 after the maturity of the policy.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified, or denied.

132

WHEREFORE, it is prayed that the petitioner's appeal be denied and that the deficiency be increased in accordance with the affirmative allegations of the second amended answer to petition and answer to amendment of petition and claim is hereby asserted for such increased deficiency.

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

OF COUNSEL:

E. O. HANSON,

Division Counsel.

THOS. H. LEWIS, JR.,

LEONARD A. SPALDING, JR.,

Special Attorneys,

Bureau of Internal Revenue.

(For Ex. A—See Ex. D to Stip., Page 117.)

[47]

UNITED STATES BOARD OF TAX APPEALS

133

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.
89294.

**Reply to Amended Answer (Filed April 17, 1939)
and to Second Amended Answer (Filed Herewith).**

134

The above named petitioner for reply to the allegations affirmatively set out by the respondent in his amended answer filed April 17, 1939, and in his second amended answer filed herewith, avers, admits and denies as follows:

4(b). Denies that the respondent erred as alleged in paragraph 4(b) of the answer as now amended.

4(c). Denies that the respondent erred as alleged in paragraph 4(c) of the answer as now amended unless it was also error on the part of the respondent to disallow the reserve deduction for supplementary contracts as alleged in paragraph 4(e) of the petition herein. The petitioner does not contend that it is entitled to both deductions in respect of its Supplementary Contracts Not Involving Life Contingencies (i.e. a reserve deduction and also a deduction for interest paid on such contracts).

135

6(a) Admits all the allegations in paragraph 6(a) of the answer as now amended except the allegations contained in the sentence:

136

*Reply to Amended Answer (Filed April 17, 1939)
and to Second Amended Answer (Filed Herewith).*

"This liability was not a life insurance reserve, was in no way connected with the reserves accumulated with respect to the petitioner's life insurance risks, and [48] was not a reserve fund required by law within the meaning and intent of section 203 (a) (2) of the Revenue Act of 1932."

which allegations are denied.

137

6(b). Admits all the allegations in paragraph 6(b) of the answer as now amended except the allegations contained in the sentence:

"The liability was not a life insurance reserve, was in no way connected with the reserves accumulated with respect to petitioner's life insurance policies, and was not a reserve fund required by law within the meaning and intent of section 203 (a) (2) of the Revenue Act of 1932."

which allegations are denied.

138

C(c) Admits the allegations contained in the sentence reading:

"During and prior to the year 1933 petitioner sold various types of life insurance policies which included provisions permitting the insured to elect with respect to the method of settlement upon maturity of the policy."

and avers that the same provisions (contained in these policies as originally issued) provided that the beneficiary would have the right to make the same elections if the insured should die before exercising this right.

*Reply to Amended Answer (Filed April 17, 1939)
and to Second Amended Answer (Filed Herewith).*

139

Denies all allegations contained in the sentence reading:

"In the absence of an election by the insured prior to the maturity of the policy, the beneficiary was granted the same privilege."

except in so far as such allegations are in accord with the averment just made, to which extent they are admitted.

Admits that the various optional modes of settlement provided for in petitioner's policies of life insurance are as shown in Exhibit A of second amended answer.

140

Admits that the petitioner paid \$1,118,594.00 of "guaranteed interest" which accrued on its Supplementary Contracts Not Involving Life Contingencies [49] which arose out of the exercise of options 1, 2 and 4; and that the respondent in determining the deficiency herein, allowed a deduction in that amount for interest accrued and paid on these supplementary contracts; but denies that the petitioner claimed any such deduction on its return.

Avers that in respect of its Supplementary Contracts Not Involving Life Contingencies, petitioner on its return claimed only the reserve deduction therefor provided by section 203 (a)(2) of the Revenue Act of 1932; that prior to the commencement of this proceeding the petitioner never claimed a deduction for interest paid on such Supplementary Contracts; and that in these proceedings the three deductions for interest paid on these Supplementary Contracts (i.e. the deduction allowed by the respondent for guaranteed interest which accrued during the year; together with the deduction claimed in paragraph 4(g) of the petition for excess interest, and that claimed in paragraph 4(h) of the petition for guaranteed interest which accrued in prior years) are claimed only in the event that

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*Reply to Amended Answer (Filed April 17, 1939)
and to Second Amended Answer (Filed Herewith).*

it should be held that the petitioner is not entitled to the reserve deduction provided for these supplementary contracts by section 203 (a)(2) of the Revenue Act of 1932, and claimed by the petitioner on its returns and in paragraph 4(e) of the petitions herein.

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Admits the allegations in the last sentence of paragraph 6(c) of the answer as now amended as to the amount of guaranteed interest which, during the year, accrued and was paid with respect to Supplementary Contracts arising out of options exercised by the insured, and with respect to such contracts arising out of options exercised by the beneficiaries.

Denies generally and specifically each and every allegation contained [50] in the amended answer or in the second amended answer, not hereinbefore admitted, qualified, or denied.

WHEREFORE, the petitioner prays that this Board may hear this proceeding and

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1. redetermine the deficiency asserted by the respondent for the taxable year 1933;

2. redetermine the petitioner's income taxes for that year free from the errors assigned in the petition and in the amendment thereof;

3. determine the amount of over-payments of tax made by the petitioner in respect of the taxable year 1933, and that such over-payments were made within two years before the filing of the petition herein;

4. deny the claims set up by the respondent in his answer as now amended; and

Reply to Amended Answer (Filed April 17, 1939) 145
and to Second Amended Answer (Filed Herewith).

5. grant to the petitioner such other and further relief as may appear to this Board to be just and proper in the premises.

(Signed) CAMPBELL E. LOCKE.
 CAMPBELL E. LOCKE,
 Attorney for Petitioner,
 120 Broadway,
 New York, N. Y.

Of Counsel:

DONALD M. DUNN, and
 JOHN L. GRANT.

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State of New York, }
 City of New York, } ss.:
 County of New York, }

ANDREW E. TUCK, being duly sworn, says that he is a Vice-President of The Equitable Life Assurance Society of the United States, the petitioner above named, and as such is duly authorized to verify the foregoing reply; that he has read the foregoing reply and is familiar with the statements contained therein, and that the facts stated are true to the best of his knowledge, information and belief.

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(Signed) ANDREW E. TUCK.
 ANDREW E. TUCK.

Subscribed and sworn to before me
 on this 24th day of May, 1939.

(Signed) HENRY M. ENSOR.

HENRY M. ENSOR.

Notary Public, Bronx County No. 33, Reg. No. 20-E-41.

Cert. filed in N. Y. Co. No. 83, Reg. No. 1-E-68.

Commission expires March 30, 1941.

(Seal)

148 [51]

UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.
89294

Docket No.
93805

149

**Motion for Leave to File Amendments of
Petitions as Heretofore Amended.**

Now comes The Equitable Life Assurance Society of the United States, by its attorney Campbell E. Locke, and respectfully asks leave of the Board to file the attached amendments of its petitions, as heretofore amended, in the above entitled proceedings, as of the date of the hearing therein on the 26th day of May, 1939.

(Sgd.) CAMPBELL E. LOCKE.

CAMPBELL E. LOCKE,

Attorney for Petitioner,

120 Broadway,

New York, N. Y.

150

Of Counsel:

DONALD M. DUNN, and

JOHN L. GRANT.

Granted

Aug 21 1939

Member

U. S. Board of Tax Appeals

[52]

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UNITED STATES BOARD OF TAX APPEALS.

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.

89294

Docket No.

93805.

152

Amendments of Petitions as Heretofore Amended.

The petitioner, The Equitable Life Assurance Society of the United States, with leave of the Board amends its petitions as heretofore amended in the above entitled proceedings, as of the date of the hearing therein on the 26th day of May, 1939, by adding to each of said petitions as heretofore amended the following paragraphs:

5(z)(1): The petitioner, within the times required by law, duly filed its returns of net income for the calendar years 1924, 1925, 1926 and 1928 under the provisions of the Revenue Acts of 1924, 1926 and 1928 respectively. Thereafter the Commissioner of Internal Revenue served upon the petitioner by registered mail notices of deficiency in taxes with respect to the taxable years 1924 and 1925 on or about the 11th day of July, 1927; with respect to the taxable year 1926 on or about the 29th day of October, 1927, and with respect to the taxable year 1928 on or about the 5th day of March, 1931. Thereafter and within the times prescribed by law, the petitioner filed with the United States Board of Tax Appeals petitions for a redetermination of [53] deficiencies set forth in said notices of deficiencies. Upon the petitions so filed, as subsequently

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154 *Amendments of Petitions as Heretofore Amended.*

amended, and the answers of the Commissioner filed there-
 to, as subsequently amended, among other issues were the
 questions whether the petitioner was entitled to deductions
 with respect to certain reserves or a portion thereof main-
 155 tained by the petitioner pursuant to State laws for the
 taxable years involved in respect to its cancelable and non-
 cancelable accident and health policies, under the provi-
 sions of the Revenue Acts of 1924, 1926 and 1928, in
 ascertaining the net income of the petitioner subject to
 taxation for the taxable years involved under the provi-
 sions of those Acts respectively. These issues and the
 other issues involved in said proceedings duly came on for
 trial at a hearing before a member of the United States
 Board of Tax Appeals held in the Borough of Manhattan
 of the City of New York on the 7th day of February,
 1935, and subsequently said Board on or about the 12th
 day of December, 1935, promulgated its opinion (33 B. T.
 A. 708) wherein, among other things, it decided that the
 reserve maintained by the petitioner pursuant to State
 laws in respect to its non-cancelable accident and health
 policies and a portion of the reserve maintained by the
 petitioner in respect to its cancelable and non-cancelable
 accident and health policies for the taxable years involved
 156 were reserves required by law within the meaning of Sec-
 tion 245(a)(2) of the Revenue Acts of 1924 and 1926 and
 Section 203(a)(2) of the Revenue Act of 1928, and that
 the petitioner was entitled to deductions with respect to
 the same accordingly. Thereafter and on or about the 5th
 day of March, 1936, said Board, pursuant to its said opin-
 ion, made and entered its decision determining the tax
 liability of the petitioner for the taxable years of 1924, [54]
 1925, 1926 and 1928 in accordance with said opinion. No
 appeal was taken from said decisions and the same there-
 fore became final before the present proceedings were
 instituted. Two of the issues involved in the present pro-

Amendments of Petitions as Heretofore Amended.

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ceedings relate to deductions from gross income in ascertaining taxable net income under the provisions of Section 203(a)(2) of the Revenue Acts of 1932 and 1934 for the years involved, with respect to a reserve entitled "Additional Reserve on Non-Cancelable Accident and Health Policies" and a reserve entitled "Unpaid and Unresisted Claims," which are the same reserves, computed in the same manner and held for the same purpose and in respect of the same or similar policies, as the reserves or portions thereof by those names involved in said prior proceedings of the petitioner against the Commissioner of Internal Revenue and with respect to which the Board decided, as aforesaid, that the petitioner was entitled to deductions. The provisions of Section 245(a)(2) of the Revenue Acts of 1924 and 1926 and of Section 203(a)(2) of the Revenue Acts of 1928, 1932 and 1934 are, for the purposes of the issues involved in these proceedings and of said prior proceedings, substantially the same. The questions upon such issues presented upon the facts and the law in these proceedings, although relating to different taxable years, are essentially the same as were involved in said prior proceedings and the decisions in said prior proceedings are *res adjudicata* of such questions and issues.

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5(z)(2): Involved in the present proceedings are issues relating to deductions with respect to reserves entitled "Unearned Accident and Health Premiums"; "Total and Permanent Disability Benefits, Active Lives" (sometimes called "Extra Reserve for Total [55] and Permanent Disability Benefits"); "Total and Permanent Disability Benefits, Disabled Lives" (sometimes called "Present Value of Amounts Incurred but not yet Due for Total and Permanent Disability Benefits"); and "Extra Reserve for Additional Accidental Death Benefits." While these reserves were not involved in said prior proceedings of the petitioner against the Commissioner of Internal

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160 *Amendments of Petitions as Heretofore Amended.*

Revenue, and concern different taxable years, the questions relating thereto are to be determined by facts and law which are essentially the same as the facts and law involved in the determination of the issues in said prior proceedings, and said reserves are in all essentials like those involved in said prior proceedings and the decisions of the Board in said prior proceedings are *res adjudicata* of the issues involved in these proceedings relating to such reserves.

(Sgd.) CAMPBELL E. LOCKE,
CAMPBELL E. LOCKE,
Attorney for Petitioner,
120 Broadway,
New York, N. Y.

161 Of Counsel:

DONALD M. DUNN, and
JOHN L. GRANT.

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Amendments of Petitions as Heretofore Amended.

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[55-A]

State of New York,
 City of New York,
 County of New York, } ss.:

ANDREW E. TUCK, being duly sworn; says that he is a Vice President of The Equitable Life Assurance Society of the United States, the petitioner above named, and as such is duly authorized to verify the foregoing amendments of the petitions in these proceedings as heretofore amended; that he has read the foregoing amendment of the petitions and is familiar with the statements contained therein, and that the facts stated are true to the best of his knowledge, information and belief. 164

ANDREW E. TUCK.

Subscribed and sworn to before me
 this 28th day of July, 1939.

HENRY M. ENSOR,
 Notary Public.

Bronx County No. 33, Reg. No. 20-E-41.

Cert. filed in N. Y. Co. No. 83, Reg. No. 1-E-68.

Commission expires March 30, 1941.

(Seal)

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166 [56]

UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No.
89294

Docket No.
93805

167

Motion for Leave to File Amendments of Replies.

Now comes The Equitable Life Assurance Society of the United States, by its attorney Campbell E. Locke, and respectfully asks leave of the Board to file the attached amendments of its replies in the above entitled proceedings, as of the date of the hearing therein on the 26th day of May, 1939.

(Signed) CAMPBELL E. LOCKE.

CAMPBELL E. LOCKE,

Attorney for Petitioner,

120 Broadway,

New York, N. Y.

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OF COUNSEL:

DONALD M. DUNN, and

JOHN L. GRANT.

Granted

Aug 21 1939

Member

U. S. Board of Tax Appeals

[57]

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UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No.
89294

**Amendment of Reply to Amended Answer
and to Second Amended Answer.**

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The petitioner, The Equitable Life Assurance Society of the United States, with leave of the Board, amends its reply to amended answer and to second amended answer in the above entitled proceeding, as of the date of the hearing therein on the 26th day of May, 1939, by changing paragraph 4(b) of that reply to read as follows:

4(b)(1): Denies that the respondent erred as alleged in paragraph 4(b) of the answer as now amended.

4(b)(2): The petitioner, within the times required by law, duly filed its returns of net income for the calendar years 1924, 1925, 1926 and 1928 under the provisions of the Revenue Acts of 1924, 1926 and 1928 respectively. Thereafter the Commissioner of Internal Revenue served upon the petitioner by registered mail notice of deficiency in taxes with respect to the taxable years 1924 and 1925 on or about the 11th day of July, 1927; with respect to the taxable year 1926 on or about the 29th day of October, 1927, and with respect to the taxable year 1928 on or about the 5th day of March, 1931. Thereafter and within the times prescribed by law, the petitioner filed with the United States Board of Tax Appeals petitions for a redetermination [58] of deficiencies set forth in said notices of deficien-

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*Amendment of Reply to Amended Answer
and to Second Amended Answer.*

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cies. Upon the petitions so filed, as subsequently amended, and the answers of the Commissioner filed thereto, as subsequently amended, among other issues were the questions whether the petitioner was entitled to deductions with respect to certain reserves or a portion thereof maintained by the petitioner pursuant to State laws for the taxable years involved in respect to its cancelable and non-cancelable accident and health policies, under the provisions of the Revenue Acts of 1924, 1926 and 1928, in ascertaining the net income of the petitioner subject to taxation for the taxable years involved under the provisions of those Acts respectively. These issues and the other issues involved in said proceedings duly came on for trial at a hearing before a member of the United States Board of Tax Appeals held in the Borough of Manhattan of the City of New York on the 7th day of February, 1935, and subsequently said Board on or about the 12th day of December, 1935, promulgated its opinion (33 B. T. A. 708) wherein, among other things, it decided that the reserve maintained by the petitioner pursuant to State laws in respect to its non-cancelable accident and health policies and a portion of the reserve maintained by the petitioner in respect to its cancelable and non-cancelable accident and health policies for the taxable years involved were reserves required by law within the meaning of Section 245(a)(2) of the Revenue Acts of 1924 and 1926 and Section 203(a)(2) of the Revenue Act of 1928, and that the petitioner was entitled to deductions with respect to the same accordingly. Thereafter and on or about the 5th day of March, 1936, said Board, pursuant to its said opinion, made and entered its decision determining the tax liability of the petitioner for the taxable years 1924, 1925, 1926 and 1928 in accordance with said [59] opinion. No appeal was taken from said decisions and the same therefore became final before the present proceedings were instituted. The provisions of Section 245(a)(2) of the Revenue Acts of 1924 and 1926

*Amendment of Reply to Amended Answer
and to Second Amended Answer.*

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and of Section 203(a)(2) of the Revenue Acts of 1928, and 1932, for the purposes of the issues involved in said prior proceedings and the issue raised in the present proceedings by paragraph 4(b) of respondent's answer as now amended, are substantially the same.

4(b)(3): The issue raised in the present proceedings by paragraph 4(b) of the respondent's answer relates to a deduction from gross income in ascertaining taxable net income under the provisions of section 203(a)(2) of the Revenue Act of 1932 for the taxable year 1933 with respect to petitioner's reserve entitled "Extra Reserve for Additional Accidental Death Benefits" and with respect to petitioner's reserve entitled "Total and Permanent Disability Benefits, Active Lives" (Sometimes called "Extra Reserve for Total and Permanent Disability Benefits"). While these reserves were not involved in said prior proceedings of the petitioner against the Commissioner of Internal Revenue, and concern different taxable years, the questions relating thereto are to be determined by facts and law which are essentially the same as the facts and law involved in the determination of the issues in said prior proceedings, and said reserves are in all essential like those involved in said prior proceedings and the decisions of the Board in said prior proceedings are *res adjudicata* of the issues involved in these proceedings relating to such reserves.

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(Signed) CAMPBELL E. LOCKE

CAMPBELL E. LOCKE,

Attorney for Petitioner,

120 Broadway,

New York, N. Y.

OF COUNSEL:

DONALD M. DUNN, and

JOHN L. GRANT.

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*Amendment of Reply to Amended Answer
and to Second Amended Answer.*

[60]

State of New York,
City of New York, } ss.:
County of New York, }

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ANDREW E. TUCK, being duly sworn, says that he is a Vice President of The Equitable Life Assurance Society of the United States, the petitioner above named, and as such is duly authorized to verify the foregoing amendment of the reply in this proceeding; that he has read the foregoing amendment of the reply and is familiar with the statements contained therein, and that the facts stated are true to the best of his knowledge, information and belief.

ANDREW E. TUCK.

Subscribed and sworn to before me
this 27th day of July, 1939.

HENRY M. ENSOR,
Notary Public.

Bronx County No. 33, Reg. No. 20-E-41,
Cert. filed in N. Y. Co. No. 83, Reg. No. 1-E-68
Commission Expires March 30, 1941.

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(Seal)

[61]

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UNITED STATES BOARD OF TAX APPEALS.

EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Nos.
89294 and
93805

Motion.

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COMES now the respondent, by his attorney, J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, and moves this Honorable Board for permission to file his answer to the amendments of petition as heretofore amended in each case and for reason therefor respondent shows the Board that petitioner has, with leave of the Board, amended its amended petitions by adding thereto certain allegations.

WHEREFORE, it is prayed that this motion be granted and upon the granting thereof the answers to the amendments of the petitions as heretofore amended stand as filed as supplements to the respondent's second amended answer to petition and answer to amendment of petition in each case.

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J. P. WENCHEL,
ECA.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

E. O. HANSON, Division Counsel,
T. H. LEWIS, Special Attorney,
Bureau of Internal Revenue.

Granted
Aug 21 1939
Member

U. S. Board of Tax Appeals.

184 [62]

UNITED STATES BOARD OF TAX APPEALS.

EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No.
89294

185

**Answer to Amendments of Petition as Heretofore
Amended (Dated July, 1939).**

The respondent, by his attorney, J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, as his answer to the amendments of the petitions as heretofore amended, admits and denies as follows:

5(z)(1): Admits the allegations of Paragraph 5(z)(1).

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5(z)(2): Denies the allegations of Paragraph 5(z)(2).

J. P. WENCHEL,
ECA.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

E. O. HANSON, Division Counsel,
T. H. LEWIS, Special Attorney,
Bureau of Internal Revenue.

[63]

UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, PETITIONER v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket Nos. 89294, 93805. Promulgated April 29, 1941.

1. During the years 1933 and 1934 the petitioner, a mutual life insurance company, maintained the following reserves: (a) additional reserve on noncancellable accident and health policies; (b) Unpaid and unresisted accident and health claims; (c) Unearned accident and health premiums; (d) Total and permanent disability benefits, active lives; (e) Total and permanent disability, disabled lives; (f) Extra reserve for additional accidental death benefits. *Held*, that the above reserves constitute "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Acts of 1932 and 1934.

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2. Assets held against a liability "present value of amounts not yet due on supplementary contracts not involving life contingencies", *held*, not to be "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Acts of 1932 and 1934.

3. Under certain of its supplementary contracts in force during 1933 and 1934 the petitioner was required to make equal installment payments over the settlement period, which installment payments were computed so as to return to the beneficiary over the settlement period interest at a guaranteed rate of 3 percent per annum. Under some such contracts such method of settlement had been elected by the insured; under others, by the beneficiary after the insured's death. *Held*, that the interest included in the installment payments made under options 2 and 4, where the election was made by the insured, is not a legal deduction from gross income, but where such method of settlement was elected by the beneficiary the interest is a legal deduction. *Penn Mutual Life Insurance Co. v. Commissioner* (C. C. A., 3d Cir.), 92 Fed. (2d) 962, followed.

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4. Upon all of its supplementary contracts not involving life contingencies the petitioner paid "interest dividends" in addition to its guaranteed rate of interest, the amount of such dividends

Opinion.

being fixed by the petitioner. *Held*, that the amounts of such interest dividends are not legal deductions from gross income. *Penn Mutual Life Insurance Co. v. Commissioner, supra*, followed.

5. During the taxable years the petitioner was obligated to pay interest upon money left with it by policyholders, the deposit, together with interest, being applied on premiums falling due during [64] the taxable years. *Held*, that the petitioner is entitled to deduct from its gross income the interest thus paid.

6. Prior to the taxable years the petitioner erected an office building, space in which was rented. A part of the capital cost of the building (\$1,651,214.92), representing contractor's fees, architect's fees, etc., was not allocated to the various component elements of the building upon which depreciation was claimed in petitioner's return. *Held*, that the petitioner is entitled to allowances for depreciation at the rates stipulated by the parties in respect of the \$1,651,214.92 item.

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Campbell E. Locke, Esq., John L. Grant, Esq., and Donald M. Dunn, Esq., for the petitioner.

Thomas H. Lewis, Jr., Esq., and L. A. Spalding, Jr., Esq., for the respondent.

OPINION.

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SMITH: These proceedings, consolidated for hearing, involve income tax deficiencies for 1933 and 1934 of \$267,677.39 and \$299,461.89, respectively. The respondent claims additional deficiencies for each of the taxable years.

The questions in issue are as follows:

(1) Is the petitioner entitled to a reserve deduction for its "additional reserve on non-cancellable accident and health policies"? (The respondent in his answer, as amended, asserts that the allowance of this deduction for 1934 was in error.)

(2) Is the petitioner entitled to a reserve deduction for a reserve called "unpaid and unresisted accident and health claims"?

Opinion.

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(3) Is the petitioner entitled to a reserve deduction for its reserve for "unearned accident and health premiums"?

(4) Is the petitioner entitled to a reserve deduction for its reserve called "total and permanent disability benefits, active lives" (sometimes called "extra-reserve for total permanent disability benefits")? (The respondent in his answer, as amended, asserts that the allowance of this deduction for 1933 was in error.)

(5) Is the petitioner entitled to a reserve deduction for its reserve called "total and permanent disability benefits, disabled lives" (sometimes called "present-value of amounts incurred but not yet due for total and permanent disability benefits")?

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(6) Is the petitioner entitled to a reserve deduction for its "extra reserve for additional accidental death benefits"? (The respondent in his answer, as amended, asserts that the allowance of this deduction for 1933 was in error.)

(7) Is the petitioner entitled to a reserve deduction for its reserve for "supplementary contracts not involving life contingencies"?

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[65] (8) Is the petitioner entitled to a deduction (as interest paid on indebtedness) for the "guaranteed" interest which, during the respective taxable years, accrued and was paid by petitioner on its supplementary contracts not involving life contingencies? (The respondent in his answer, as amended, asserts that the allowance of this deduction for 1933 and 1934 was in error. The petitioner claims this deduction only as an alternative to the reserve deduction involved in issue 7.)

(9) Is the petitioner entitled to a deduction (as interest paid on indebtedness) for "guaranteed" interest which it

accrued in prior years on its supplementary contracts not involving life contingencies and which was paid by the petitioner during the respective taxable years? (Petitioner appeals from the respondent's determination of deficiencies for 1933 and 1934, which were computed without allowing this deduction, but the petitioner claims this deduction only as an alternative to the reserve deduction involved in issue 7.)

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(10) Is the petitioner entitled to a deduction (as interest paid on indebtedness) for "excess interest dividends" which during the respective taxable years accrued and were paid by the petitioner on its supplementary contracts not involving life contingencies? (Petitioner appeals from the respondent's determination of deficiencies for 1933 and 1934, which were computed without allowing this deduction, but the petitioner claims this deduction only as an alternative to the reserve deduction involved in issue 7.)

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(11) Is the petitioner entitled to a deduction (as interest paid on indebtedness) for the amount of interest which during the respective taxable years it credited to funds which it held on demand and which (together with such funds) it applied to the payment of premiums becoming due on its policies, all in accordance with the agreements under which such funds were held?

(12) Is the petitioner entitled to a deduction for depreciation on the improvements on the farms which it owned during the respective taxable years? (The respondent concedes this issue and agrees that the depreciation shall be taken upon the stipulated costs of the improvements on the farms at the stipulated rates.)

Opinion.

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(13) Is the petitioner entitled to a deduction for depreciation on its home office building in respect of the architect's fees, contractor's fees, and other general costs not allocated to the various component elements of the building?

These proceedings have been submitted to the Board upon a signed stipulation of facts, a supplementary stipulation of facts, and exhibits, all of which are made a part of our findings by reference.

[66] At all times material herein the petitioner was a mutual life insurance company; a corporation organized and existing under and by virtue of the laws of the State of New York, with its principal office and place of business in the Borough of Manhattan, City, County, and State of New York, and engaged in the business of issuing and selling life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), and accident and health insurance contracts.

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From some time prior to the taxable year 1933 continuously to the present time the petitioner has been duly authorized in every state of the United States, except Texas, to transact the business of issuing life insurance and annuity contracts and has been transacting that business in each of such states, except Texas, pursuant to the laws thereof. During this entire time more than 50 percentum of the petitioner's total reserve funds have been held for the fulfillment of its life insurance and annuity contracts.

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For convenience of treatment the findings of fact and opinion applicable to groups of issues raised will be set forth in order.

Issues 1-6

FACTS.—During 1933 and 1934 the petitioner had outstanding life insurance and annuity contracts (including

contracts of combined life, health and accident insurance) and accident and health insurance policies. The six reserves covered by the first six issues in these proceedings were maintained and computed as required by the laws of the State of New York and by the rules and regulations of the insurance commissioner of that state, and also as required by the laws of other states in which the petitioner did business, and the rules and regulations of the insurance commissioners of such other states; and, as so required, the petitioner at all times held admitted assets sufficient to provide for these and for all other reserves and liabilities.

OPINION.—The above reserves have received the consideration of the Board in the following cases:

Equitable Life Assurance Society of the United States, 33 B. T. A. 708;

Monarch Life Insurance Co., 38 B. T. A. 716;

Pan-American Life Insurance Co., 38 B. T. A. 1439;

Oregon Mutual Life Insurance Co. (Memorandum Opinion entered Jan. 4, 1939), Docket Nos. 85182 and 88299.

In all the Board has held that the reserves were reserves required by law within the meaning of section 203 (a) (2) of the Revenue Acts of 1932 and 1934. Our decision in 204 *Monarch Life Insurance Co.*, *supra*, was affirmed (C. C. A., 1st Cir.), 114 Fed. (2d) 314, in *Pan-American Life Insurance Co.*, *supra* (C. C. A., 5th Cir.), 111 Fed. (2d) 366, which was in turn affirmed by the Supreme Court, 311 U. S. [67] 272, and in *Oregon Mutual Life Insurance Co.*, *supra*, 112 Fed. (2d) 468; *affd.*, 311 U. S. 267.

In support of his argument that these reserve funds are not "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Acts of 1932 and 1934, the respondent cites *New World Insurance Co. v. United States*, 26 Fed. Supp. 444. The Supreme Court affirmed the decision of the lower court in that case, with the following comment:

Opinion.

* * * the views expressed on the second question considered by the Court of Claims as to the right of deduction on account of insurance reserves not being an essential basis for the judgment and being contrary to *Helvering v. Oregon Mutual Life Insurance Co.* No. 564, decided this day.

Upon the authority of the above cited cases the contentions of the petitioner that these reserves are "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Acts of 1932 and 1934 are sustained.

Issues 7, 8, 9, 10.

FACTS.—The facts relating to these issues have been stipulated as follows:

XXXI

During and prior to the calendar years 1933 and 1934, the taxpayer issued life insurance policies which gave to the insured and in some cases to the beneficiary the right to require the taxpayer to apply the net sum due under the policy upon its maturity, in accordance with one of the optional modes of settlement set up in Stipulation Exhibit D attached hereto and made a part hereof. Options exercised under provisions 1, 2, or 4 of Stipulation Exhibit D are generally known as "Supplementary Contracts not Involving Life Contingencies" and are so referred to in these proceedings. To provide for the payment of life policies which had matured and were payable during 1933 and subsequent years under these "Supplementary Contracts not Involving Life Contingencies" the petitioner carried on its books a liability (which the petitioner contends is a reserve liability) named "Present Volume of Amounts not yet Due on Supplementary Contracts not Involving Life Contingencies", in the following respective amounts at the beginning and end of the calendar years 1933 and 1934:

	Year	Beginning of Year	End of Year
1933	\$34,806,201	\$42,326,682
1934	42,326,682	52,942,995

The mean of these amounts for 1933 is \$38,566,441.50 of which 48% was held in respect of supplementary contracts arising from options exercised by the insured during his or her lifetime, and 52% was held in respect of supplementary contracts arising from options exercised by the beneficiaries after the policies involved had matured.

[68] The mean of these amounts for 1934 is \$48,134,838.50 of which 47% was held in respect of supplementary contracts arising from options exercised by the insured during his or her lifetime, and 53% was held in respect of supple-

Opinion.

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Of the mean of the "Present Value of Amounts Not Yet Due on Supplementary Contracts Not Involving Life Contingencies" held by the petitioner at the beginning and end of each of the taxable years, the following percentages were the present values of amounts not yet due under the different options set out in Stipulation Exhibit D exercised as indicated:

Option 1 exercised by insured		1933	1934
2		27.52%	28.20%
4		15.36%	14.10%
1		5.12%	4.70%
2	beneficiary	42.99%	44.52%
4		6.76%	6.36%
		2.25%	2.12%
Total		100.00%	100.00%

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		1933	1934
Option 1 exercised by insured		\$ 307,007	\$ 372,894
" 2 " " " "		173,983	188,402
" 4 " " " "		57,994	62,801
" 1 " " beneficiary		480,191	583,244
" 2 " " " "		74,564	80,744
" 4 " " " "		24,855	26,915
Total		\$1,118,594	\$1,315,000

XXXIII

The petitioner paid "guaranteed interests" which had accrued in prior years on these supplementary contracts at the guaranteed rate of 3 per cent. in the amount of \$13,432.49 in 1933 and in the amount of \$14,237.50 in 1934. The respondent, in computing the taxes involved in these proceedings, allowed no deductions for these amounts of "guaranteed interest" which accrued in prior years but which were paid during the taxable years involved herein.

XXXIV

Of the \$13,432.49 disallowed as a deduction for such "guaranteed interest" paid during the year 1933, \$5,238.67 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$8,193.82 was paid

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with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured. Of the \$14,237.50 disallowed as a deduction for such "guaranteed interest" paid during the year 1934, \$5,552.63 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$8,684.87 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising Out of Options which were exercised by the beneficiaries after the policies involved had matured.

[70] The "guaranteed interest" which had accrued in prior years on petitioner's Supplementary Contract Not Involving Life Contingencies and which was paid by petitioner during the taxable years here involved, was all paid under option 1 the provisions of which are set forth in Stipulation Exhibit D.

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XXXV

In 1933 and 1934, at the beginning of each calendar year, the petitioner, by resolution of its Board of Directors declared an excess interest dividend over and above the guaranteed 3 per cent per annum with respect to the amounts held by it under the "Supplementary Contracts not Involving Life Contingencies." The term "excess interest dividend" is herein used in the same sense as it is used in the supplementary contracts as set out in Stipulation Exhibit D attached hereto and made a part hereof. Respondent determined that such excess interest dividends did not constitute interest within the meaning of section 203 (a) (8) of the Revenue Acts of 1932 and 1934.

XXXVI

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The petitioner paid excess interest dividends which accrued during the year on its "Supplementary Contracts not Involving Life Contingencies," at the rate declared for the year by its Board of Directors, in the amount of \$534,887.54 in 1933 and in the amount of \$545,463.93 in 1934. In computing the taxes involved in these proceedings the respondent allowed deductions under section 203 (a) (8) of the Revenue Acts of 1932 and 1934, in the amounts stated in paragraphs XXXI of this stipulation, for the "guaranteed interest" which accrued on these supplementary contracts during each of the years 1933 and 1934 and which was paid in the year that it accrued, but allowed no deduction for the excess interest dividend which was paid on these contracts in each of those years.

XXXVII

Of the \$534,887.54 of such excess interest dividends paid during the year 1933, \$256,746.02 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised

Of the \$545,463.93 of such excess interest dividends paid during the year 1934, \$256,368.05 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$289,095.88 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured.

The petitioner's claims in these proceedings for deductions in the amount of guaranteed interest accrued in prior years and paid in 1933 and 1934, and for deductions in the amount of the excess interest dividends paid in 1933 and 1934, all as described in this and in the four preceding paragraphs, are in the alternative to its claims for reserve deductions under section 203 (a) (2) of the Revenue Acts of 1932 and 1934 computed upon the amounts described in paragraph XXXI hereof, named "Present Value of Amounts not yet Due on Supplementary Contracts not Involving Life Contingencies" which the petitioner contends are "reserve funds required by law" within the meaning of that section.

[71] The excess interest dividends paid by the petitioner on its Supplementary Contracts Not Involving Life Contingencies, accrued and were paid as follows under the different options set out in Stipulation Exhibit D, exercised as indicated:

	1933	1934
Option 1 exercised by insured	\$147,201.05	\$153,820.84
2	82,158.73	76,910.41
4	27,386.24	25,636.80
1 exercised by beneficiary	229,930.32	242,840.53
2	36,158.40	34,691.51
4	12,052.80	11,563.84
Total	\$534,887.54	\$545,463.93

Exhibit D referred to in the stipulation provides in material part as follows:

MODES OF SETTLEMENT AT MATURITY OF POLICY

The Insured may elect to have the net sum due under this policy upon its maturity applied under one or more of the following optional modes of settlement in lieu of the lump sum provided for on the first page hereof, and in the absence of such an election by the Insured, the beneficiary, after the Insured's death, may so elect. The beneficiary, after the Insured's death, may designate (with the right to change such designation) the person to whom any amount remaining unpaid at the death of the beneficiary shall be paid if there be no such person designated by the Insured and surviving. Such election, designation or request for change shall be in writing and shall not take effect until filed with the Society at its Home Office and endorsed upon the policy or the supplementary contract, if any.

Opinion.

1. Deposit Option:

Left on deposit with the Society at interest guaranteed at the rate of 3% per annum, with such Excess Interest Dividend as may be apportioned.

2. Instalment Option:

Fixed Period.

Paid in a fixed number of equal annual, semi-annual, quarterly or monthly instalments as set forth in the following table.

3. Life Income

Option:

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Paid in equal annual, semi-annual, quarterly or monthly instalments for five, ten or twenty years certain as may be elected and continuing during the remaining lifetime of the beneficiary as shown in the following table.

4. Instalment Option:

Fixed Amount.

Paid in equal annual, semi-annual, quarterly or monthly instalments of such amount as may be agreed upon until the net sum due under this policy together with interest on the unpaid balances at the rate of 3% per annum, and such Excess Interest Dividends as may be apportioned, shall be exhausted, the final payment to be the balance [72] then remaining with the Society. If the interest and Excess Interest Dividend for any year shall be in excess of the instalments payable in such year, then the total amount of the instalments for the subsequent year shall be increased by the amount of such excess.

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Excess Interest Dividend: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of instalment under Option 2, the amount of income during the fixed period of five, ten or twenty years under Option 3, and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society.

No option of settlement elected by the Insured hereunder can be changed nor can any payment thereunder be commuted, except by the Insured's written order filed with the Society at its Home Office.

Under Options 2, 3, and 4, the first installment will be due upon receipt of due proof of death. * * *

Opinion.

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There is also made a part of the stipulation of facts Exhibit A with regard to an endowment policy. The options granted by this policy are similar to those contained in the ordinary life policy, Exhibit D, the only difference being that upon the maturity of the endowment policy the proceeds may be paid to the insured.

The third option contained in Exhibit D provides for installment payments during the settlement period which ends with the death of the beneficiary. The instant proceeding is not concerned with supplementary contracts involving the third option.

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OPINION.—In its income tax returns for 1933 and 1934 the petitioner treated its supplementary contract reserves not involving life contingencies as “reserve funds required by law” within the meaning of section 203 (a) (2) of the Revenue Acts of 1932 and 1934 and deducted from the gross income of each year $3\frac{3}{4}$ percent of the mean of such reserve funds at the beginning and end of the year. In the determination of the deficiencies the respondent has disallowed the deductions claimed. The petitioner contends that the supplementary contract reserves are “reserve funds required by law” within the meaning of the above mentioned section of the Revenue Acts of 1932 and 1934; in the alternative, it contends that it is at least entitled to deduct from gross income as interest paid on indebtedness all of the interest paid on such supplementary contracts during the taxable years, including the excess interest dividends.

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We consider first the contention of the petitioner that the supplementary contract reserves constitute “reserve funds required by law” within the meaning of section 203 (a) (2) of the Revenue Acts of 1932 and 1934.

[73] In *Helvering v. Illinois Life Insurance Co.*, 299 U. S. 88, the Supreme Court used this language:

* * * Its [the life insurance company's] life insurance liability arises upon the death of the insured. Ascertainment of the reserves attributable to

that liability involves consideration of the amount contributed to them out of premiums plus interest for a period estimated on the basis of mortality. * * *

In *Helvering v. Inter-Mountain Life Insurance Co.*, 294 U. S. 686, the Supreme Court said:

* * * "reserve funds" may not reasonably be deemed to include values that do not directly pertain to insurance. In life insurance the reserve means the amount, accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts. * * * Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency, * * *

***Penn Mutual Life Insurance Co.*, 32 B. T. A. 876, involved the question of whether supplementary contract reserves were "reserve funds required by law" within the meaning of the Revenue Act of 1928. The Board said at page 880:**

* * * It will be seen that the Supreme Court interprets "reserve funds required by law" as meaning only the reserve funds held by a life insurance company against the contingency of death of the insured. In the instant proceeding the reserve in question represents proceeds of matured ordinary life insurance policies which were held under an agreement. These funds were not held subject to the contingency of death of the insured, since the insured had already died. Immediately after that event the petitioner had the money representing the face of the policy in each instance, which was subject to the demand of the beneficiary. Any reserve thereafter carried to meet such demand in reality constituted a reserve to meet the contractual liability of the petitioner to the beneficiary, with whom it stood in the relationship of debtor and creditor. We accordingly hold that the reserve in question did not constitute "reserve funds required by law" within the meaning of section 203 (a) (2) of the Revenue Act of 1928; and upon the recomputation the deduction which was allowed by the respondent will be disallowed.

The petitioner argues that the question as to whether supplementary contract reserve constitute "reserve funds required by law" was before the court in *Mutual Benefit Life Insurance Co. v. Herold* (1912), 198 Fed. 199; that although that case was concerned with the proper construction of the words "reserve funds required by law" as used in the Corporation Excise Tax Act of 1909, nevertheless, that statute is *in pari materia* with the income tax acts

beginning with 1913; and that the ruling of the court in that case is equally applicable to the instant proceeding. The petitioner further points out that under all of the income tax acts beginning with 1913 through 1934 the respondent has held in his regulations that supplementary contract reserves constitute "reserve funds required by law." Thus, in article 147 (d) of [74] Regulations 33, promulgated under the provisions of the Revenue Act of 1913, and the same article in Regulations 33 (Revised), it is provided:

(d) The reserve funds of insurance companies to be considered in computing the deductible net addition to reserve funds are held to include only the reinsurance reserve and the reserve for supplementary contracts required by law in the case of life insurance companies. * * *

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In article 569 of Regulations 45, approved April 17, 1919, it is provided:

* * * In the case of life insurance companies the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts not involving life contingencies," and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible. * * *

The same provision was contained in article 569, Regulations 45 (1920 Edition).

Article 681 of Regulations 62, 65, and 69, issued under the Revenue Acts of 1921, 1924, and 1926, provides:

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* * * Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10, and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19, and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. * * *

Article 971 of Regulations 74 and 77, issued under the Revenue Acts of 1928 and 1932, provides in part:

* * * Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual state-

ment for life insurance companies, and items 16-19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. * * *

From the liability page of the annual statements of life insurance companies, referred to in these regulations and used by life insurance companies for the years 1920 to 1925, inclusive, item 9, and, for the years 1926, to 1934, inclusive, item 10 read: "Present value of amounts not yet due on supplementary contracts *not* involving life contingencies."

It was not until Regulations 86 was promulgated under the provisions of the Revenue Act of 1934, approved February 11, 1935, that a change was made in the respondent's regulations relative to the meaning of the phrase "reserve funds required by law" so as to exclude from such reserve funds the so-called supplementary contract reserves. In article 203 (a) (2)-1 of Regulations 86 it was said that the reserve funds required by law referred to by the Revenue Act of 1934 did not include "liability on supplementary [75] contracts not involving life contingencies." Treasury Decision 4615; Cumulative Bulletin XIV-2, p. 310, approved December 18, 1935, amended prior regulations beginning with Regulations 62, issued under the Revenue Act of 1921, to conform to the above ruling made in article 203 (a) (2)-1 of Regulations 86.

The petitioner argues, upon the basis of *Helvering v. Reynolds Tobacco Co.*, 306 U. S. 110; that Congress must be presumed to have intended the Revenue Acts of 1932 and 1934 to be interpreted as prior income tax acts were interpreted with respect to the issue under consideration.

But a regulation of the Commissioner which is contrary to and not consistent with the statute will be disregarded by the courts. See *Morrill v. Jones*, 106 U. S. 466; *Robinson v. Lundrigan*, 227 U. S. 173; *Commissioner v. Winslow*, 113 Fed. (2d) 418. The regulations and prac-

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tices of administrative départements are entitled to weight and serious consideration in construing a statute, but it is for the courts to determine the meaning of a statute, and not an executive department of the Government. A Treasury regulation is merely an expression of opinion as to the meaning of the law by the official charged with its enforcement. *Edwards v. Douglas*, 269 U. S. 204; *Weld v. Nichols*, 9 Fed. (2d) 977. We think it clear that the respondent's regulations which have permitted supplementary contract reserves to be regarded as "reserve funds required by law" are contrary to the interpretation placed upon that phrase by the Supreme Court over a long period of years. A question cognate to that herein involved was before the Supreme Court in *New York Life Insurance Co. v. Edwards*, 271 U. S. 109. In that case the insurance company claimed that it was entitled to deduct from gross income as a net addition to reserve funds required by law an increase in its liability in respect of unreported losses. The Court stated:

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4. A number of policy holders died during the calendar year, but their deaths were not reported before it terminated. The superintendent of insurance required the company to set aside a special fund to meet these unreported losses, and it claimed that this was an addition to the reserve fund required by law. We think this claim was properly rejected by the commissioner, although the courts below held otherwise. *McCoach v. Insurance Co. of North America*, 37 S. Ct. 709, 244 U. S. 585, 61 L. Ed. 1333, and *United States v. Boston Insurance Co.*, 46 S. Ct. 97, 269 U. S. 197, 70 L. Ed. 232 (November 23, 1925), pointed out that "the net addition, if any, required by law to be made within the year to reserve funds," does not necessarily include whatever a state official may so designate; that "reserve funds" has a technical meaning. It is unnecessary now to amplify what was there said. The item under consideration represented a liability and not something reserved from premiums to meet policy obligations at maturity.

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[76] In our opinion the Supreme Court's interpretation of the phrase "reserve funds required by law" must be given effect. The supplementary contract reserves of petitioner represent amounts of assets retained to meet the

company's liabilities upon insurance policies which had already matured. They do not represent assets held against unmatured policies. The petitioner is therefore not entitled to deduct from the gross income of each of the years 1933 and 1934 $3\frac{3}{4}$ percent of the mean of its supplementary contract reserves not involving life contingencies.

239 The second question for consideration on this issue is the amount of interest which the petitioner is entitled to deduct from gross income in making payments during the taxable years under its supplementary contracts not involving life contingencies.

Section 203 (a) of the Revenue Act of 1932 provides in material part as follows:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) GENERAL RULE.—In the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(8) INTEREST.—All interest paid, or accrued within the taxable year on its indebtedness, except [exception not material] * * *

240 Section 203 (a) of the Revenue Act of 1934 is the same as above except that the words "or accrued" have been omitted from subdivision (8).

Treasury Decision 4615, C. B. XIV-2, p. 310, approved December 18, 1935, amends article 975 of Regulations 77 and article 203 (a) (8)-1 of Regulations 86, and provides:

(4) If a life insurance company pays interest on the proceeds of life insurance policies left with it pursuant to the provisions of supplementary contracts, not involving life contingencies, or similar contracts, the interest so paid shall be allowed as a deduction from gross income, except that such deduction shall not be allowed in respect of interest accrued in any prior taxable year to the extent that the company has had the benefit of a deduction of 4 percent or $3\frac{3}{4}$ per cent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds.

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It is the contention of the petitioner that, if it is not entitled to consider its supplementary contract reserves as "reserve funds required by law", it must be because such reserve funds constitute indebtedness; that, since the applicable statutes and the Commissioner's regulations provide for the deduction from gross income of *all* interest paid upon indebtedness, then the petitioner is entitled to deduct the full amount of the interest as shown by the stipulated facts which it paid during the taxable years 1933 and 1934 pursuant to the provisions of its supplementary contracts. It points [77] out that in *Duffy v. Mutual Benefit Life Insurance Co.*, 272 U. S. 613, the Supreme Court said:

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* * * Until the maturity of a policy, the policyholder is simply a member of the corporation, with no present enforceable right against the assets. Upon the maturity of the policy he becomes a creditor with an enforceable right. Then for the first time there is an indebtedness. See *Mayer v. Attorney General*, 32 N. J. Eq. 815, 820-822. In the meantime, each member bears a relation to the mutual company analogous to that which a stockholder bears to the joint stock company in which he holds stock. * * *

The interest with which we are concerned in these proceedings was paid upon supplementary contracts under options 1, 2, and 4 of the policy above set out. Under these options petitioner obligated itself to pay interest or to include in installment settlements interest at the guaranteed rate of 3 percent per annum. It was provided, however, that:

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* * * if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of instalment under Option 2, * * * and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society.

We shall consider first the interest paid at the guaranteed rate of 3 percent per annum. On brief the respondent concedes upon the basis of *Penn Mutual Life Insurance Co.*, 32 B. T. A. 876, and *Penn Mutual Life Insurance Co.*

v. *Commissioner*, 92 Fed. (2d) 962; that the petitioner is entitled to deduct from gross income the guaranteed interest paid pursuant to policy contracts under option 1.

245 Under option 2 the petitioner obligates itself to make installment payments certain over a period of years, each installment payment to include interest at the guaranteed rate of 3 percent per annum. The respondent contends that the interest included in the installment payments is not deductible from gross income. In *Penn Mutual Life Insurance Co. v. Commissioner*, *supra*, the United States Circuit Court of Appeals for the Third Circuit held that deductions would be allowed for interest included in installment payments under options exercised by beneficiaries after the death of the insured, but that no deductions would be allowed in such cases where the options had been exercised by the insured. The court said (92 Fed. (2d) at p. 967):

246 Now dealing with the instalment settlements thus contracted for, under the Trust Certificate policy or under the Ordinary Life policy when the option has been exercised within the lifetime of the insured, we find the obligations thus created are plainly obligations of policy rather than obligations of debt. The face of the policies bears an obligation to pay in instalments and at given dates. There can be no obligation to pay, first, until the policy has matured by the death of the insured, and second, until the arrival of the due dates of the respective instalment payments. Such a policy matures upon the death of the [78] insured. Upon maturity its nature changes from a policy obligation to an obligation of debt, but, before such an obligation of debt can bear interest, it must become due. When the due date arrives it will bear interest and not before.

We understand the reasoning of the court to be that in a case where the insured elects the option the principal of the indebtedness on the maturity of the policy is not the face amount of the policy but the face amount of all of the installment payments to be made in settlement of the policy. Where in such case the insurance company makes an installment payment it is not paying both principal and interest, but is paying principal only. Since

in such case the petitioner is not paying interest on indebtedness, it is not entitled to deduct as interest paid on indebtedness the amount of interest included in the installment payment. We therefore hold with respect to interest paid on supplementary contracts covered by option 2 that the petitioner is entitled to deduct only the amount of interest included in installment payments where the beneficiary after the death of the insured or after the maturity of the policy elects the option.

Under option 4 petitioner obligates itself to make:

* * * equal annual, semi-annual, quarterly or monthly instalments of such amount as may be agreed upon until the net sum due under this policy together with interest on the unpaid balances at the rate of 3% per annum, and such Excess Interest Dividends as may be apportioned, shall be exhausted, the final payment to be the balance then remaining with the Society.

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We know of no reason why the interest included in installment payments under option 4 should be treated any differently from the interest in installment payments under option 2. The only difference between the two is that in option 4 the "amount" is fixed, whereas in option 2 the "period" is fixed. We do not think that this difference requires any different treatment so far as the deductibility of the guaranteed interest is concerned. We therefore hold, with respect to interest paid on supplementary contracts covered by option 4, that the petitioner is entitled to deduct only the amount of interest included in installment payments where the beneficiary after the death of the insured or after the maturity of the policy elects the option.

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We next consider the question of the excess interest dividends. The facts pertaining to this question are substantially the same as the facts involved in *Penn Mutual Life Insurance Co. v. Commissioner, supra*, under the heading "As to the 'Additional Interest' Awarded to the Policies by the Board of Trustees and Paid Out During

the Years 1926 and 1928." Under such circumstances it follows that our decision on this question must likewise be the same as in the cited case. We, therefore, sustain the respondent's determination in disallowing as interest paid on indebtedness the amounts of \$534,887.54 [79] for 1933 and \$545,463.93 for 1934. *Penn Mutual Life Insurance Co. v. Commissioner, supra.*

251 It will be noted from the excerpt from Treasury Decision 4615, quoted above, that the respondent has held that a life insurance company may not deduct from gross income of the taxable year "interest accrued in any prior taxable year to the extent that the company has had the benefit of a deduction of 4 per cent. or $3\frac{3}{4}$ per cent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds." It has been stipulated that during the years 1933 and 1934 the petitioner paid guaranteed interest in the amount of \$13,432.49 and \$14,237.50, respectively, which interest had accrued in prior years. The respondent contends that by virtue of his regulation the petitioner may not deduct during the years 1933 and 1934 the above mentioned amounts of guaranteed interest paid.

252 The petitioner is a life insurance company. It makes its returns on a cash receipts and disbursements basis. Under the respondent's present contention the petitioner was not entitled for years prior to 1933 to include in its "reserve funds required by law" the supplementary contract reserves. By reason of the fact that it made its returns upon such basis for years prior to 1933 the respondent undertakes to correct for 1933 and 1934 an error made in a prior year by disallowing a deduction which the petitioner is entitled to make under the taxing statutes. But mistakes made in the audit of a prior year may not be charged against a taxpayer for a succeeding year. *Wobber Brothers*, 35 B. T. A. 890; *Schmidlapp v. Commissioner* (C. C. A., 2nd Cir.),

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96 Fed (2d) 680, 683. In *Lansing McVickar*, 37 B. T. A. 758, the Board said at page 762: "The error for 1930 may not be corrected by a deliberately erroneous computation of the tax for 1931."

It will be noted from the Commissioner's regulations referred to above that no part of the interest paid on indebtedness during the taxable year is to be disallowed except "to the extent that the company has had the benefit of a deduction of 4 per cent or $3\frac{3}{4}$ percent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds." The record does not show that the petitioner had any such benefit during prior years. We are of the opinion that the contention of the respondent upon this point is without merit.

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Issue 11.

FACTS.—During the taxable years 1933 and 1934, and prior thereto, the petitioner accepted funds from certain accident and health policyholders [80] under an agreement with each such policyholder that it would hold on demand the fund accepted from him and supplement it with interest at a specified rate; that, in the event the policyholder did not demand the repayment of the fund, it would apply the fund, together with the interest supplement, in payment of premiums subsequently becoming due on the policyholder's policy; but that at any time prior to the due date of such premiums, it would, upon the policyholder's demand, repay the fund to the policyholder. These funds are not included in the amounts of unearned accident and health premiums for which the petitioner herein claims reserve deductions. The interest supplements made by the petitioner in accordance with such agreements, and applied

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— during the year to premiums as they become due, amounted to \$4,525.68 in 1933; and to \$5,220.19 in 1934. The respondent in computing the taxes involved in these proceedings allowed no deduction for such interest supplements so made and applied during the taxable years herein involved, and no deduction in respect of the funds supplemented.

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OPINION.—If the petitioner had paid the amount of interest here in question to the policyholder there could be no question as to the right to the deduction claimed. See *Pan-American Life Insurance Co.*, 38 B. T. A. 1430. It is the respondent's contention that, since the interest was not paid to the policyholder but was credited to him in settlement of premiums due, the amount does not constitute the payment of interest on indebtedness. In support of his position the respondent cites *Illinois Life Insurance Co.*, 30 B. T. A. 1160, in which we held that, where a life insurance company accepted the payment of premiums in advance and granted a discount on the payment, the amount of the discount did not constitute the payment of interest upon indebtedness. This was for the reason that the insurance company was not indebted to the policyholder for anything. Those are not the facts here. The petitioner owed the policyholder interest upon a deposit of money made by him. The payment of the interest in liquidation of a liability of the policyholder to the petitioner constitutes a payment within the meaning of the income tax act. Thus in *Lynchburg Trust & Savings Bank v. Commissioner*, 68 Fed. (2d) 356; certiorari denied, 292 U. S. 640, in quoting from *Commissioner v. Stearns* (C. C. A. 2d Cir.), 65 Fed. (2d) 371, 373, it was said: "'Credit' for practical purposes is the equivalent of 'payment'." Clearly if A owes B \$10 interest upon a note and B owes A an equal amount for merchandise purchased, the credit by A to B's account of \$10 is a payment of the interest by A of the \$10. The situa-

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Opinion.

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tion here is parallel. The action of the respondent upon this issue is reversed.

[81]

Issue 13.

FACTS.—During the taxable years 1933 and 1934 petitioner owned and in part occupied its home office building located at 393 Seventh Avenue, New York City. This building was constructed on a cost plus basis. Petitioner capitalized as a part of the cost of the building the architect's fee, the contractor's fee, and certain other miscellaneous general expenses incurred in the course of construction in the total amount of \$1,651,214.92, not allocated to the cost of the various component elements of the building. These various component elements of the building such as steel, plumbing, elevators, etc., are depreciated at appropriate rates upon the basis of their respective costs which do not include any part of the above mentioned capitalized general expenses. These capitalized general expenses consist of the following:

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General conditions	\$419,260.19
Contractor's fee	492,397.95
Architect's fee	524,861.19
Home office supervisors	189,729.32
Own alterations	24,966.27

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A reasonable allowance for depreciation in respect of the above building costs for each of the years 1933 and 1934 is 2½ percent of the amount of these capitalized costs.

OPINION.—The respondent claims that the petitioner is not entitled to depreciation in respect of the above referred to capitalized costs of \$1,651,214.92 upon the ground that they represent the cost of intangibles. As we understand the respondent's position it is that they can not be allocated to the various component elements of the building, such as steel, plumbing, elevators, etc.

Opinion.

The evidence of record shows the break-up of the above referred to costs. We do not perceive any reason why all of the capitalized costs are not a part of the cost of petitioner's building. Clearly the architect's fee and the contractor's fee are as much a part of the cost of the building as the wages paid to the masons, carpenters, etc. All of these items represent a part of the cost of the building. It is immaterial that they can not be allocated to the component elements of the building subject to depreciation at different rates. The parties have stipulated that a reasonable rate for depreciation upon these capitalized costs, if they are subject to a depreciation allowance, is $2\frac{1}{2}$ percent. We hold that these capitalized costs are depreciable and that the petitioner is entitled to a depreciation allowance for each year at the stipulated rate.

Reviewed by the Board.

Decision will be entered under Rule 50.

[82]

STERNHAGEN did not participate in the consideration of or decision in this report.

BLACK, dissenting: I dissent from that part of the majority opinion which holds that the reserve maintained by petitioner for the ultimate payment of its obligations in respect of amounts not yet due on supplementary contracts not involving life contingencies are not reserves required by law.

I think these reserves are "Reserve funds required by law," within the meaning of section 203 of the Revenue Act of 1932 and 1934, which are applicable to these proceedings. I, therefore, think that under this section petitioner is entitled, in determining its net income, to a deduction of

3¾ per cent of the mean of the reserve funds in question held at the beginning and the end of the taxable years.

It seems to me that these particular reserves are just as valid and essential as any that the life insurance companies are required to maintain. As said by the court in *Mutual Benefit Life Insurance Co. v. Herold*, 198 Fed. 199; affirmed on another point, 201 Fed. 918; certiorari denied, 231 U. S. 755, "These obligations seem to come fairly within the definitions of reserve, as above given. Notwithstanding the policy-holder has died, there still remain unpaid under the policy certain installments not presently due, but which will mature from time to time in the future. These are as much policy obligations as they would have been if payable in one sum immediately upon the death of the insured. They have a value, and that value must be estimated, and, when estimated, adequate provision made for their payment as they mature, which can only be done by the establishment of a suitable reserve. Furthermore, such reserves are 'required by law' within the meaning of the act. As appears by the agreed statement of facts, the commissioners of insurance of all the states require the establishment of a reserve to cover the obligations of the company on such supplementary policy contracts. This fact of itself tends strongly to show that they are required by law."

266

267

While it is true that *Mutual Benefit Life Insurance Co. v. Herold*, *supra*, was decided in 1912, and dealt with the Corporation Tax Act of 1909, nevertheless I think what the court said respecting reserves for the fulfillment of obligations under these supplementary contracts not involving life contingencies being "reserves required by law" is entirely appropriate to the revenue acts which are applicable in the instant proceedings. The taxable years which we have before us are the years 1933 and 1934 and the applicable regulations are Regulations 77 and Regulations 86.

[83] At the time petitioner filed its income tax return

for the year 1933, the Treasury Regulations (art. 971, Regulations 77) held that the type of reserve here involved was a reserve required by law. Substantially the same provisions were contained in all of the regulations issued under all of the revenue acts beginning with the Revenue Act of 1921. Shortly after the Court of Claims handed down its decision in *Continental Assurance Co. v. United States*, 8 Fed. Supp. 474, the Treasury changed its regulations and provided that certain reserves maintained by life insurance companies which had been recognized in the regulations as "reserves required by law" should no longer be so considered. One of these was a reserve maintained for supplementary contracts not involving life contingencies.

269

In *Pan-American Life Insurance Co.*, 38 B. T. A. 1430, we discussed in considerable detail this change in the Treasury regulations and we pointed out that there had been no corresponding change in the statute which would justify such a change in the regulations.

270

We held that the Commissioner's changed regulations were invalid as to reserves for incurred but not yet accrued disability benefits maintained by the taxpayer insurance company, and that these reserves were reserves required by law, and that the taxpayer was entitled to deduct 3¾ percent of the mean of these reserves held at the beginning and end of the taxable year. Our decision was affirmed by the Fifth Circuit, 111 Fed. (2d) 366, and was affirmed by the Supreme Court in *Helvering v. Pan-American Life Insurance Co.*, 311 U. S. 372. In that opinion and in the opinion of *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267, decided on the same day, the Supreme Court referred to the change in regulations made by the Commissioner referred to above and held that such change, in so far as it affected the reserves involved in those cases, was beyond the statute and was therefore invalid. While it is true that the Supreme Court's decisions in the *Oregon*

Mutual Life Insurance Co. and the *Pan-American Life Insurance Co.* cases involved disability reserves and not reserves for supplementary contracts not involving life contingencies, as here involved, nevertheless I think the same fundamental reasoning which caused the Supreme Court to hold that disability reserves are reserves "required by law" would require a holding that reserves to meet an insurance company's liability under its supplementary contracts, is a reserve "required by law." I think that would be particularly true as to those policies where the insured himself has directed that the deferred payment plan of settlement with the beneficiary be used. As to the reserves maintained to ultimately pay these policies improved annually by interest, the Commissioner has denied all deduction for interest because, as he says, when these options [84] of settlements have been elected by the insured within his lifetime the obligations thus created are the obligations of the policy rather than obligations of debt. This view has been upheld by the Third Circuit in *Penn Mutual Life Insurance Co. v. Commissioner*, 92 Fed. (2d) 962, and by the Fifth Circuit in *Pan-American Life Insurance Co., supra*, and is upheld in the majority opinion in the instant case.

272

If these decisions are correct on this point, and I think they are, then plainly the option settlements where elected by the insured in his lifetime are policy obligations and reserves to insure payment of these obligations are reserves "required by law" within the meaning of the applicable statute and the majority opinion errs in disallowing a deduction of $3\frac{3}{4}$ percent of the mean of these reserves in determining petitioner's net income for the years 1933 and 1934. It follows of course that if petitioner were allowed a deduction of $3\frac{3}{4}$ percent of the mean of these reserves, it would not be entitled to a deduction for interest. This, petitioner concedes.

273

It may well be that a different rule applies to these policies where after the decedent dies the beneficiary of the policy elects to leave the proceeds with the life insurance company and take deferred settlements including interest rather than lump sum payments. As to these the majority opinion allows the deduction of guaranteed interest, following *Penn Mutual Life Insurance Co. v. Commissioner, supra*, and *Pan-American Life Insurance Co., supra*, and disallows the deduction of $3\frac{3}{4}$ percent of the mean of the reserves applicable to these particular supplementary contracts.

275

As to that part of the majority opinion there may be considerable logic to support it. The strongest impediment against it would be the Commissioner's own regulations from 1921 to 1932, inclusive. But be that as it may, I do emphatically disagree as to the holding of the majority concerning the reserves maintained by petitioner to fulfill its obligations on those supplementary contracts which represent elections made by the insured during his lifetime and which both the Board and the courts have held to be policy obligations and not mere indebtedness created by choice of the beneficiary, after the death of the insured.

ARUNDELL agrees with this dissent.

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44 B. T. A.

[85]

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UNITED STATES BOARD OF TAX APPEALS,
WASHINGTON.

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No.
89294

278

Decision.

Pursuant to the opinion of the Board promulgated April 29, 1941, the respondent herein on July 5, 1941 having filed a recomputation of tax and the petitioner on July 16, 1941 having filed an agreement to such recomputation, now, therefore, it is

ORDERED and DECIDED: That there is an overpayment of income tax for the calendar year 1935 in the amount of \$40,173.79, all of which amount was paid after the mailing of the deficiency notice (Sec. 809 [c], Revenue Act of 1938).

279

(Signed) C. R. ARUNDELL,
Member.
[Seal]

Enter:

Entered Jul. 17, 1941.

280 [86]

UNITED STATES CIRCUIT COURT OF APPEALS,
SECOND CIRCUIT.

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,
Petitioner on Review,

against

GUY T. HELVERING, Commissioner of
Internal Revenue,
Respondent on Review.

B. T. A.
Docket No.
89294

281

Petition for Review.

To the Honorable Judges of the United States Circuit
Court of Appeals for the Second Circuit:

Now comes The Equitable Life Assurance Society of
the United States, by its attorney, Campbell E. Locke, and
respectfully shows:

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I

The petitioner on review (hereinafter referred to as
the petitioner) is The Equitable Life Assurance Society
of the United States, a corporation organized and existing
under and by virtue of the laws of the State of New York,
and is an inhabitant of the judicial circuit of the United
States Circuit Court of Appeals for the Second Circuit.
At all times throughout the year 1933 and for many years
prior thereto, the petitioner was engaged in the business
of issuing and selling life insurance and annuity contracts
(including contracts of combined life, health and accident
insurance), holding more [87] than fifty per centum of its

Petition for Review.

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reserve funds for the fulfillment of such contracts, and having, as it still does, its principal office and place of business at 393 Seventh Avenue, Borough of Manhattan, City, County and State of New York.

II

The respondent on review (hereinafter referred to as the Commissioner) is the Commissioner of Internal Revenue, holding his office by virtue of the laws of the United States.

NATURE OF THE CONTROVERSY

284

III

The petitioner filed its income tax return for the calendar year 1933, being the taxable year involved herein, with the Collector of Internal Revenue for the Third District of New York, at his office which is located within the judicial circuit of the United States Circuit Court of Appeals for the Second Circuit.

IV

On March 6, 1937, the Commissioner sent a notice to the petitioner by registered mail, of a deficiency which he had determined in the petitioner's income taxes for the year 1933 in the amount of \$267,677.39. Thereafter, on June 1, 1937, the petitioner filed a petition with the United States Board of Tax Appeals for a redetermination of the deficiency, praying the Board to find that there was no deficiency and to find further that the petitioner had made an overpayment of its income tax for the year 1933 in the amount of \$182,168.23, [88] being the sum of three deficiencies for that year totalling \$160,338.66 together with interest on those deficiencies totalling \$21,829.57, all of which had been determined by the Commissioner, assessed by the

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Petition for Review.

Collector and paid by the petitioner prior to March 6, 1937. The Commissioner filed his answer on July 21, 1937. Amended answers, amendments to the petition, a reply and an amended reply were subsequently filed.

V

287

This proceeding was duly consolidated for hearing and decision with another proceeding involving the same issues in respect to the petitioner's income taxes for 1934. No appeal is taken by the petitioner from the Board's decision in the latter proceeding. At the hearing on May 26, 1939, the consolidated proceedings were submitted to the Board upon a stipulation of facts, a supplementary stipulation of facts and exhibits, all of which were made a part of the Board's findings. The consolidated proceedings were reviewed by the Board which promulgated its opinion on April 29, 1941, together with a dissenting opinion in which two Board Members concurred. On July 17, 1941, the Board entered its final order of redetermination and decision to the effect that there was no deficiency due for the year 1933 and that the petitioner had made an overpayment of its income tax for that year in the amount of \$40,173.79.

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VI

In his determination the Commissioner had refused to allow a reserve deduction claimed by the petitioner under Section 203(a)(2) of the Revenue Act of 1932 on account of its [89] Reserve for Supplementary Contracts Not Involving Life Contingencies, a fund maintained with interest by the petitioner through the year 1933 to provide for its obligations arising as follows:

Life insurance policies issued by the petitioner during and prior to the year 1933, provided that any of four optional modes of settlement, in lieu of a lump sum payment,

might be elected by the insured or, in the event the insured should elect none, by the beneficiary. These options when elected in accordance with the policy provisions are known as "supplementary contracts," and they require the petitioner to hold the proceeds of the policies after maturity, supplement these proceeds with interest (at the rate guaranteed in the policy together with "excess interest dividends" at a rate determined for each year by the petitioner's Board of Directors), and to pay out the face amounts of such policies so supplemented with interest, in instalments or otherwise, over varying periods of time. One of these options, designated Option 3, which provides for payments conditioned upon the life of the beneficiary, is not involved in this proceeding. Payments under the other three options designated Options 1, 2 and 4, provided for in the petitioner's policies, were not contingent upon the life of the beneficiary, and these three options, when elected in accordance with the terms of the policy, are known as Supplementary Contracts Not Involving Life Contingencies.

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VII

[90] To provide for payments to become due in the future under these Supplementary Contracts Not Involving Life Contingencies, the petitioner throughout 1933 was required by law in the States where it was doing business, to maintain a fund at all times equal to the present value of such future payments. The amount of this fund, so required and so maintained, was, at the beginning of 1933, \$34,806,201, and at the end of 1933 it was \$42,326,682. The mean of these two amounts is \$38,566,441.50. In computing the petitioner's taxes the Commissioner, on the ground that this fund is not a reserve fund within the meaning of Section 203(a)(2) of the Revenue Act of 1932, refused to allow a deduction of $3\frac{3}{4}\%$ of this mean amount. As to this item, the Board, in its decision, sustained the Commissioner's determination, and the petitioner seeks a review of the decision in that regard.

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VIII

In his answer as amended, the Commissioner asserted that he had erred in allowing the petitioner a deduction for interest at the guaranteed rate paid during the year on the Supplementary Contracts involved herein, a deduction which the petitioner claimed only as an alternative to the reserve deduction described above. On brief the Commissioner conceded that the allowance of this deduction was proper as to one type of the exercised options, designated Option 1. As to the remaining types, designated Options 2 and 4, the Board decided that where the options had been exercised, not by the beneficiary, [91] but by the insured, the petitioner was not entitled to a deduction, as interest paid on indebtedness, of \$231,977 of guaranteed interest paid during the year on options of these types, so exercised, and the petitioner seeks a review of the decision in that regard.

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IX

The petitioner claimed that if it was not entitled to a reserve deduction on account of its Reserve for Supplementary Contracts Not Involving Life Contingencies, it was entitled to a deduction as interest paid on indebtedness of the amount of all interest paid during the year on these supplementary contracts, including \$534,887.54 of excess interest called "excess interest dividends," determined and paid during the year pursuant to the policy provisions under which the options had been exercised. The Board, upholding the Commissioner, decided that the petitioner was not entitled to a deduction of the excess interest so paid, and the petitioner seeks a review of the decision in that regard.

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X

There is no dispute as to the facts, all facts material to the issues involved, which had to be proved by either

Petition for Review:

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party, having been set out in writing, agreed to and stipulated by the parties, and found by the Board as so stipulated and agreed.

COURT IN WHICH REVIEW IS SOUGHT**XI**

The petitioner seeks a review of the Board's decision by [92] the United States Circuit Court of Appeals for the Second Circuit.

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ASSIGNMENTS OF ERROR**XII**

There is manifest error in the opinion, decision and final order of redetermination rendered and entered herein by the United States Board of Tax Appeals, to the prejudice of the petitioner, who assigns the following errors and each of them as having occurred in the said opinion, decision and final order of redetermination:

1. The Board erred in failing to find and decide that the petitioner had overpaid its income taxes for the year 1933 in the sum of \$182,168.23, and is entitled to a refund thereof.

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2. The Board erred in deciding, determining and ordering that the petitioner's Reserve for Supplementary Contracts Not Involving Life Contingencies was not a reserve fund for which a deduction is allowable by Section 203(a)(2) of the Revenue Act of 1932.

3. The Board erred in failing to find and decide that the petitioner was entitled, under Section 203(a)(2) of the Revenue Act of 1932, to a reserve deduction in the amount

Petition for Review.

of \$1,446,241.56, being $3\frac{3}{4}\%$ of the mean of the petitioner's reserve fund for Supplementary Contracts Not Involving Life Contingencies required by law and held at the beginning and end of the taxable year 1933.

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4. The Board erred in deciding, determining and ordering [93] that the petitioner's obligations under options 2 and 4 of the optional modes of settlement at maturity contained in its policies, which had been exercised by the insured in accordance with the provisions of the policies, did not constitute indebtedness within the meaning and intent of Section 203(a)(8) of the Revenue Act of 1932.

5. The Board erred in deciding, determining and ordering that the petitioner was not entitled to a deduction as interest paid on indebtedness, within the meaning and intent of Section 203(a)(8) of the Revenue Act of 1932, of the guaranteed interest which the petitioner paid during the year 1933 pursuant to its policy provisions, upon its Supplementary Contracts Not Involving Life Contingencies which arose from the insured's exercise of said options 2 and 4, in the amount of \$231,977.

300

6. The Board erred in deciding, determining and ordering that the excess interest which the petitioner paid during the year 1933 upon its Supplementary Contracts Not Involving Life Contingencies, pursuant to the policy provisions under which options of settlement at maturity were exercised, and determined pursuant to those provisions, did not constitute interest paid on indebtedness within the meaning and intent of Section 203(a)(8) of the Revenue Act of 1932.

7. The Board erred in deciding, determining and ordering that the petitioner was not entitled to a deduction as interest paid on indebtedness, within the meaning and in-

Petition for Review.

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tent of Section 203(a)(8) of the Revenue Act of 1932, of excess interest which the petitioner paid during the year 1933 pursuant to the [94] policy provisions of its policies in the amount of \$534,867.54, determined pursuant to those provisions, on its Supplementary Contracts Not Involving Life Contingencies which arose from the exercise of options 1, 2 and 4 of the optional modes of settlement at maturity contained in the policies.

8. The Board erred in its conclusions of law and in its application of the law to the facts in deciding, determining and ordering that the petitioner was not entitled to the deductions disallowed as set forth above.

302

9. The Board erred in that there is no finding of fact in its findings nor in its opinion to sustain the Board's conclusions of law upon which the deductions set forth above were disallowed.

10. The Board erred in that its opinion, decision, determination and order as to these disallowed deductions, based upon its findings of fact, are contrary to law.

WHEREFORE, the petitioner prays that the decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit, and that a transcript of the record be prepared in accordance with the law and with the rules of said Court for filing and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

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CAMPBELL E. LOCKE,

CAMPBELL E. LOCKE,

Attorney for Petitioner on Review,

120 Broadway,

New York, N. Y.

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Petition for Review.

[95]

State of New York, }
 County of New York, } ss.:

ANDREW E. TUCK, being duly sworn, says that he is a Vice President of the petitioner in the above entitled proceeding; that he has read the foregoing petition for review and knows the contents thereof, and that said petition is true of his own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters he believes it to be true.

305

ANDREW E. TUCK.

Subscribed and sworn to before me
 this 22nd day of September, 1941.

HENRY M. ENSOR,
 Notary Public.

(Seal)

Bronx County No. 27, Reg. No. 20-E-43.
 Cert. filed in N. Y. Co. No. 117, Reg. No. 3-E-84.
 Commission Expires March 30, 1943.

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[96]

UNITED STATES CIRCUIT COURT OF APPEALS,
SECOND CIRCUIT.

307

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,
Petitioner on Review,

against

GUY T. HELVERING, Commissioner of
Internal Revenue,
Respondent on Review.

B. T. A.
Docket No.
89294

308

Notice of Filing Petition for Review.

To

Guy T. Helvering,
Commissioner of Internal Revenue,
Washington, D. C.

J. P. Wenchel, Chief Counsel,
Bureau of Internal Revenue,
Washington, D. C.

You are hereby notified that The Equitable Life Assurance Society of the United States, the petitioner in the above entitled proceeding, did on the 7th day of October, 1941, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit of a decision of the Board heretofore rendered in the above entitled proceeding. A copy of the petition for review and assignments of error as filed is hereto attached and served upon you.

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Dated this 8th day of October, 1941.

CAMPBELL E. LOCKE,
Attorney for Petitioner on Review,
120 Broadway,
New York, N. Y.

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Stipulation of Facts.

Service of a copy of the petition for review is hereby acknowledged this 10th day of Oct., 1941.

(Sgd.) J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

[97]

UNITED STATES BOARD OF TAX APPEALS.

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THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Nos.
89294 and
93805

Stipulation of Facts.

312

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, provided however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be true:

I

At all times material herein the petitioner, hereinafter sometimes called "the taxpayer," is and was a mutual insurance company; a corporation organized and existing under and by virtue of the laws of the State of New York, with its principal office and place of business at 393 Seventh

Stipulation of Facts.

313

Avenue, Borough of Manhattan, City, County and State of New York, and engaged in the business of issuing and selling life insurance and annuity contracts (including contracts of combined life, health and accident insurance) and accident and health insurance contracts.

[98]

II

(a) The taxpayer commenced business in the State of New York in the year 1859 as a stock life insurance company and was converted under the Insurance Law of New York to a mutual life insurance company in the year 1925. From the year 1859 continuously to the present time, the taxpayer has been duly authorized to transact the business of life insurance and other kinds of insurance in the State of New York and has been transacting such business in that State pursuant to the laws thereof.

314

(b) From sometime prior to the taxable year 1933 continuously to the present time, the taxpayer has been duly authorized in every State of the United States, except Texas, to transact business of issuing life insurance and annuity contracts and has been transacting that business in each such State pursuant to the laws thereof. During this entire time more than fifty per centum of the taxpayer's total reserve funds have been held for the fulfillment of its life insurance and annuity contracts.

315

(c) For the years 1933 and 1934 and for the preceding years the taxpayer, as required by the laws of the State of New York, made annual reports (herein called annual statements) to the Superintendent of Insurance of the State of New York upon blanks which were furnished by him and which were in the form adopted for life insurance companies by the National Convention of Insurance Commissioners.

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Stipulation of Facts.

III

(a) The respective copies of the notices of deficiencies and of the accompanying statements and schedules attached to the petitions and marked "Exhibit A" are true copies of such notices, statements and [99] schedules mailed by the respondent to the taxpayer on the following dates:

Docket No. 89294	March 6, 1937
Docket No. 93805	February 28, 1938

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(b) The taxes in controversy are income taxes for the calendar years 1933 (Docket No. 89294) and 1934 (Docket No. 93805).

(c) Income taxes assessed against the taxpayers for the year 1933 have been collected from the taxpayer in the following amounts on the dates indicated:

<i>Date</i>	<i>Deficiency</i>	<i>Interest</i>	<i>Total</i>
March 3, 1936	\$58,642.16	\$6,801.69	\$ 65,443.85
April 28, 1936	56,733.90	7,078.12	63,812.02
March 8, 1937	44,962.60	7,949.76	52,912.36
			<hr/> \$182,168.23

318

The above payments were made in satisfaction of assessments set out in Schedule 2 of page 5 of the notice of deficiency dated March 6, 1937 (Exhibit A of petition in Docket Number 89294) under the classification: "Total previously assessed."

IV

Petitioner issues various standard forms of life insurance policies such as Ordinary Life, Twenty Payment Life,

Stipulation of Facts.

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Endowment, etc., all of which are issued on the participating plan, and some of which also include provisions for total and permanent disability benefits and/or additional accidental death benefits. The total premium shown on the face of each policy covering combined life, health and accident insurance includes: (1) The premium paid for the life insurance coverage; and (2) the premium paid for the disability coverage; and/or (3) the premium paid for [100] the additional accidental death coverage. The premium paid for the disability coverage and the premium paid for the additional accidental death coverage are stated separately elsewhere in the policy.

320

The terms of each policy include the following:

(1) The cancelation or the termination of the life insurance automatically cancels or terminates the disability and/or the accident insurance.

(2) The policyholder may discontinue the disability and/or the accident insurance on any policy anniversary date without canceling the life insurance and without affecting the life insurance premium. In such event, the total premium shown on the face of the policy would be reduced by the amount of the premium for disability insurance and/or the amount of the premium for accident insurance specified in the policy.

321

(3) The disability and additional accidental death benefits are not included in any paid-in term insurance, or other paid-up benefits granted upon the surrender or lapse of the policy; nor does any reserve held on account thereof reduce the amount of the reserve held on account of the life insurance covered by the policy, or increase the surrender, cash, or loan value shown in the "Table of Loan and Non-forfeiture Values."

V

[101] The various reserve liabilities and other liabilities of the petitioner are constantly changing. An item which

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Stipulation of Facts.

constitutes part of one reserve now may, within a few hours constitute part of a different reserve, be divided between two reserves, or cease to be a part of any reserve. But the petitioner usually values its reserves, i. e., computes its various reserve liabilities, only as of the close of business on December 31st of each year and as of such other date as called for by State authorities, generally as of the close of business on the last day of each quarter.

323

The expression "transferred from a reserve as of a valuation date," as used in this stipulation, indicates that the amount or item referred to has ceased to be a part of that reserve liability since an earlier valuation date and has not been included in the later valuation. In like manner the expression "transferred to a reserve" indicates that the item referred to has become a part of this reserve liability since an earlier valuation date and is included in the later valuation.

The use of the terms "reserve," "reserve fund" and "reserve liability" in this stipulation to describe any liability or amount pertaining to the issues involved herein, is not to be deemed an admission by the respondent that such liability or amount is a "reserve."

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VI

Attached hereto and marked "Stipulation Exhibit A" and made a part hereof is a sample combined life, health and accident insurance policy issued on January 1, 1933, to John Doe, at age 35, for \$1,000, on the twenty year endowment plan, premiums payable for twenty years, and containing provisions for total and permanent disability and additional accidental death benefits. The total annual premium for the combined life, health and accident insurance [102] is \$56.99, as shown on the first page of said sample policy. The annual premium for total and permanent disability benefits is \$4.08 and the annual premium

Stipulation of Facts.

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for additional accidental death benefits is \$1.00 as also shown on the first page of said sample policy. The fourth page thereof contains the usual provisions pertaining to total and permanent disability benefits and additional accidental death benefits, respectively.

[103]

XXXI

During and prior to the calendar years 1933 and 1934, the taxpayer issued life insurance policies which gave to the insured and in some cases to the beneficiary the right to require the taxpayer to apply the net sum due under the policy upon its maturity, in accordance with one of the optional modes of settlement set up in Stipulation Exhibit D attached hereto and made a part hereof. Options exercised under provisions 1, 2 or 4 of Stipulation Exhibit D are generally known as "Supplementary Contracts not Involving Life Contingencies" and are so referred to in these proceedings. To provide for the payment of life policies which had matured and were payable during 1933 and subsequent years under these "Supplementary Contracts not Involving Life Contingencies" the petitioner carried on its books a liability (which the petitioner contends is a reserve liability) named "Present Value of Amounts not yet Due on Supplementary Contracts not Involving Life Contingencies," in the following respective amounts at the beginning and end of the calendar years 1933 and 1934:

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<i>Year</i>	<i>Beginning of Year</i>	<i>End of Year</i>
1933	\$34,806,201.00	\$42,326,682.00
1934	42,326,682.00	53,942,995.00

The mean of these amounts for 1933 is \$38,566,441.50 of which 48% was held in respect of supplementary contracts arising from options exercised by the insured during his

Stipulation of Facts.

or her lifetime, and 52% was held in respect of supplementary contracts arising from options exercised by the beneficiaries after the policies involved had matured.

The mean of these amounts for 1934 is \$48,134,838.50 of which 47% was held in respect of supplementary contracts arising from options exercised by the insured during his or her lifetime, and 53% was held in respect of supplementary contracts arising from options exercised by the beneficiaries after the policies involved had matured.

[104] This liability carried on petitioner's books was an amount which, if maintained with annual interest increments, would exactly equal petitioner's obligations under the Supplementary Contracts Not Involving Life Contingencies. The obligations arising under these option contracts were absolute obligations of the petitioner and were not in any sense contingent upon the happening of future events. For the purpose of providing for these obligations, the taxpayer was required to accumulate and maintain this liability by the statutes of the states in which it was then doing business and by the rulings of state officials made pursuant to authority conferred upon them by such statutes, and as so required the petitioner at all times held admitted assets sufficient to provide for this and all other reserves and/or liabilities. In computing the taxes involved in these proceedings, the respondent determined that the liability called "Present Value of Amounts not yet Due on Supplementary Contracts not Involving Life Contingencies" and that portion of petitioner's admitted assets held to provide therefor, did not constitute a reserve fund within the meaning of the Revenue Acts of 1932 and 1934 and allowed no deduction in respect to it under section 203 (a) (2) of said Revenue Acts, but did allow deductions under section 203 (a) (8) of those Acts for the "guaranteed interest" paid by the petitioner on these "Supplementary Contracts not Involving Life Contingencies," which accrued during the taxable year and was paid in that year. The deduc-

Stipulation of Facts.

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tion allowed by the respondent for such "guaranteed interest" accrued and paid during the year was \$1,118,594.00 for 1933 and \$1,315,000.00 for the year 1934.

XXXII

Of the \$1,118,594.00 allowed as a deduction for such "guaranteed interest" paid during the year 1933, \$538,984.00, was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$579,610.00 [105] was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured. Of the \$1,315,000.00 allowed as a deduction for such "guaranteed interest" paid during the year 1934, \$624,097.00 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$690,903.00 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured. In these proceedings the respondent maintains that he erred in so far as he allowed deductions with respect to the "guaranteed interest." The term "guaranteed interest" is herein used in the same sense as it is used in the Supplementary Contracts set out in the Stipulation Exhibit D.

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XXXIII

The petitioner paid "guaranteed interest" which had accrued in prior years on these supplementary contracts at the guaranteed rate of 3 per cent, in the amount of \$13,432.49 in 1933 and in the amount of \$14,237.50 in 1934.

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Stipulation of Facts.

The respondent, in computing the taxes involved in these proceedings, allowed no deductions for these amounts of "guaranteed interest" which accrued in prior years but which were paid during the taxable years involved herein.

XXXIV

335

Of the \$13,432.49 disallowed as a deduction for such "guaranteed interest" paid during the year 1933, \$5,238.67 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$8,193.82 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured. Of the \$14,237.50, [106] disallowed as a deduction for such "guaranteed interest" paid during the year 1934, \$5,552.63 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$8,684.87 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured.

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XXXV

In 1933 and 1934, at the beginning of each calendar year, the petitioner by resolution of its Board of Directors declared an excess interest dividend over and above the guaranteed 3 per cent per annum with respect to the amounts held by it under the "Supplementary Contracts not Involving Life Contingencies." The term "excess interest dividend" is herein used in the same sense as it is used in the supplementary contracts as set out in Stipulation

Stipulation of Facts.

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Exhibit D attached hereto and made a part hereof. Respondent determined that such excess interest dividends did not constitute interest within the meaning of section 203 (a)(8) of the Revenue Acts of 1932 and 1934.

XXXVI

The petitioner paid excess interest dividends which accrued during the year on its "Supplementary Contracts not Involving Life Contingencies," at the rate declared for the year by its Board of Directors, in the amount of \$534,887.54 in 1933 and in the amount of \$545,463.93 in 1934. In computing the taxes involved in these proceedings the respondent allowed deductions under section 203 (a)(8) of the Revenue Acts of 1932 and 1934, in the amounts stated in paragraph XXXI of this stipulation, for the "guaranteed interest" which accrued on these supplementary contracts during each of the years 1933 and 1934 and which was paid in the year that it accrued, but allowed no deduction for the excess interest dividend which was paid on these contracts [107] in each of those years.

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XXXVII

Of the \$534,887.54 of such excess interest dividends paid during the year 1933, \$256,746.02 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the insured during his or her lifetime and \$278,141.52 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured.

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Of the \$545,463.93 of such excess interest dividends paid during the year 1934, \$256,368.05 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by

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Stipulation of Facts.

the insured during his or her lifetime and \$289,095.88 was paid with respect to Supplementary Contracts Not Involving Life Contingencies Arising out of Options which were exercised by the beneficiaries after the policies involved had matured.

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The petitioner's claims in these proceedings for deductions in the amount of guaranteed interest accrued in prior years and paid in 1933 and 1934, and for deductions in the amount of the excess interest dividends paid in 1933 and 1934, all as described in this and in the four preceding paragraphs, are in the alternative to its claims for reserve deductions under section 203 (a) (2) of the Revenue Acts of 1932 and 1934 computed upon the amounts described in paragraph XXXI hereof, named "Present Value of Amounts not yet Due on Supplementary Contracts not Involving Life Contingencies" which the petitioner contends are "reserve funds required by law" within the meaning of that section.

[108] Dated, May 23, 1939.

342

(Sgd) CAMPBELL E. LOCKE.
CAMPBELL E. LOCKE,
Counsel for Petitioner.

J. P. WENCHEL,
E. O. H.
J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES

A MUTUAL COMPANY

ORGANIZED JULY 26, 1859

HEREBY INSURES THE LIFE OF

--- JOHN DOE ---
(HEREIN CALLED THE INSURED)

And agrees to pay at its Home Office in the City of New York

--- ONE THOUSAND ---
(HEREIN CALLED THE FACE AMOUNT)

Dollars,

to the Insured
the First day of January, Nineteen hundred
and Fifty-three, the date of the maturity of the Endowment, if the Insured be
then living, or, in the event of the Insured's death prior to said date

to the Insured's wife, --- MARY DOE --- beneficiary

(with the right to the Insured to change the beneficiary or assign this policy)

upon receipt of due proof of the Insured's death, provided premiums have been duly paid and this policy is then in force and is then surrendered properly released. And the Society agrees to INCREASE THE AMOUNT SO PAYABLE

to --- TWO THOUSAND --- Dollars,
in event of the Insured's DEATH FROM ACCIDENT, as defined in the Double Indemnity provision on the fourth page hereof, subject to the conditions therein set forth, provided such death occurs prior to the maturity of the Endowment. And if the Insured, before the anniversary of the Register date of this policy upon which the Insured's age at nearest birthday is 60 years, becomes TOTALLY and presumably PERMANENTLY DISABLED as defined in the Total and Permanent Disability provision on the fourth page hereof, the Society will, subject to the conditions of such provision, waive subsequent premiums and pay to the Insured a

and Fifty-three, the date of the maturity of the Endowment, if the Insured be then living, or, in the event of the Insured's death prior to said date

to the Insured's wife, --- M A R Y D O E --- beneficiary
(with the right to the Insured to change the beneficiary or assign this policy)

upon receipt of due proof of the Insured's death, provided premiums have been duly paid and this policy is then in force and is then surrendered properly released. And the Society agrees to **INCREASE THE AMOUNT SO PAYABLE**

to --- TWO THOUSAND --- Dollars,
in event of the Insured's **DEATH FROM ACCIDENT**, as defined in the Double Indemnity provision on the fourth page hereof, subject to the conditions therein set forth, provided such death occurs prior to the maturity of the Endowment. And if the Insured, before the anniversary of the Register date of this policy upon which the Insured's age at nearest birthday is 60 years, becomes **TOTALLY** and presumably **PERMANENTLY DISABLED** as defined in the Total and Permanent Disability provision on the fourth page hereof, the Society will, subject to the conditions of such provision, waive subsequent premiums and pay to the Insured a


DISABILITY INCOME OF --- T E N --- **DOLLARS A MONTH**

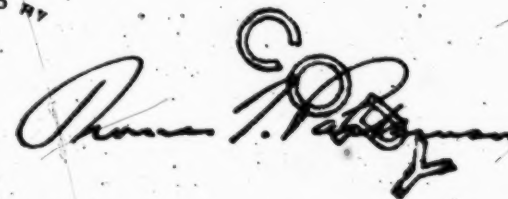

This insurance is granted in consideration of the payment in advance to the Society of

Fifty-six and 99/100 Dollars,
and of the payment annually thereafter of a like sum
upon each first
day of January until
Twenty full years' premiums shall have been paid, or until the prior death of the
Insured. These payments include a annual premium of \$1.00
for the Double Indemnity and of \$4.08 for the Total and Permanent Disability provision hereof.

THE PROVISIONS of the subsequent pages hereof form a part of this contract as fully as if recited at length over the signatures hereto affixed. This policy is executed at the Home Office of the Society in New York on its date of issue, the Third day of January 1935

EXAMINED BY

 Secretary.

 President.
 Asst Registrar.

2703. 30, 6.
De. Acc. & Disab.
End.

INSURANCE PAYABLE IN 20 YEARS OR PRIOR DEATH. DOUBLE INDEMNITY FOR FATAL ACCIDENT.
TOTAL AND PERMANENT DISABILITY BENEFITS. WAIVER OF PREMIUMS. MONTHLY DISABILITY INCOME.
PREMIUMS PAYABLE FOR 20 YEARS UNLESS DIVIDENDS APPLIED TO SHORTEN PREMIUM PAYING PERIOD.
ANNUAL DIVIDENDS.

SECOND PAGE.

**(Entries on this page are to be made only by the Society at its Home Office in New York.
No other entries will be recognized.)**

CHANGE OF BENEFICIARY REGISTER.		
DATE ENDORSED	BENEFICIARY	ENDORSED BY

THIRD PAGE.

INCONTESTABILITY AND FREEDOM OF TRAVEL, RESIDENCE AND OCCUPATION.

This policy, except as to the provisions relating to Disability and Double Indemnity, shall be (a) **INCONTESTABLE** after it has been in force during the lifetime of the Insured for a period of one year from its date of issue, provided premiums have been duly paid, and (b) **FREE FROM RESTRICTIONS** on travel, residence, occupation or military or naval service.

PARTICIPATION IN DIVIDENDS.

The proportion of divisible surplus accruing upon this policy shall be ascertained annually. At the end of the second and each subsequent policy year any surplus apportioned by the Society to this policy as a Dividend shall, at the option of the Insured, be:

1. Paid in cash; or
2. Applied toward the payment of any premium due on this policy if the remainder of such premium is duly paid; or
3. Applied to the purchase of paid-up Additional Endowment Insurance without Disability or Double Indemnity benefits, and the Insured may at any time (provided the cash value of such Additional Insurance has not been applied to purchase paid-up Endowment or extended term insurance in accordance with the provisions hereof entitled "Options on Surrender or Lapse" set forth on the fifth page hereof) surrender such Additional Insurance and receive the cash value thereof which shall not be less than the original cash Dividend; or
4. Left to accumulate at 3% interest, compounded annually, and if in any year the Society declares that funds held under this Option shall receive interest in excess of 3% per annum the accumulation hereunder shall be increased by an Excess Interest Dividend in an amount to be determined and apportioned by the Society. Any Dividend accumulations under this Option will be payable to the Insured on demand on any anniversary of the Register date of this policy.

If the Insured does not elect one of the foregoing Options within three months after the mailing by the Society of a notice requiring such election, the Dividend shall be applied as provided under Option 3. If the Insured dies after the first policy year and while this policy is in force, such cash dividend as may be apportioned by the Society for the fraction of the then current policy year elapsed before such death will be allowed.

Any Additional Endowment Insurance and any Dividends or accumulations remaining unpaid at the maturity of this policy shall be payable at the same time and in the same manner as the face hereof unless otherwise provided herein.

If the Insured does not elect one of the foregoing options, the Society of a notice requiring such election, the Dividend shall be applied as provided under Option 3. If the Insured dies after the first policy year and while this policy is in force, such cash dividend as may be apportioned by the Society for the fraction of the then current policy year elapsed before such death will be allowed.

Any Additional Endowment Insurance and any Dividends or accumulations remaining unpaid at the maturity of this policy shall be payable at the same time and in the same manner as the face hereof unless otherwise provided herein.

CONVERSION TO PAID-UP POLICY. The Society, upon written request and the return of this policy, will convert this policy into a fully paid-up participating Endowment policy to mature at the same date as this policy for the face amount of insurance hereunder, whenever the reserve on this policy and on any dividend additions together with any dividend accumulations equals the net single premium for such paid-up policy (based on the American Experience Table of Mortality with 3% interest at the Insured's attained age) including the single premium required for any Disability and Double Indemnity provisions then in force under this policy which the Insured desires to continue under such paid-up policy. Any indebtedness to the Society existing against this policy will continue as a lien against the paid-up policy.

MATURITY AT EARLIER DATE. Whenever during the lifetime of the Insured the reserve on this policy and on any dividend additions together with any dividend accumulations equals the face amount hereof, the Society, upon surrender of this policy with due release, will regard this policy as a matured Endowment and will pay to the Insured the face amount of insurance hereunder less any indebtedness.

TOTAL AND PERMANENT DISABILITY.

Upon receipt of due proof as hereinafter provided that the Insured, while this policy was in force and no premium hereunder in default, became totally disabled as hereinafter defined due to bodily injury or disease before the anniversary of the Register date of this policy upon which the Insured's age at nearest birthday is 60 years and that such Total Disability has existed continuously for at least four months, the Society will, subject to the conditions set forth below, presume such Total Disability to be permanent and

(a) Waive payment of all premiums upon this policy falling due after the commencement of such Total Disability and during its continuance, except that no premium falling due more than one year prior to receipt at the Home Office of the Society of written notice of claim shall be waived; and

(b) Pay to the Insured for the fourth and each subsequent completed month of such Total Disability during its continuance the monthly Disability Income stated on the first page hereof, provided, however, that no Income shall be payable for any period of Total Disability more than one year prior to receipt at the Home Office of the Society of written notice of claim. The first payment hereunder shall be made upon receipt of such due proof and an additional payment upon the completion of each additional month of such Total Disability during its continuance.

If such proof shows that the Insured has been committed by a Court as an insane person or committed as a ward or patient in an incorporated institution for mental cases or is otherwise incompetent to transact any business or to care for self, and that no legal representative of the Insured's estate has been appointed and qualified, the Society at its election may make any payment hereunder to any beneficiary, named in this policy, as trustee for the Insured. Any payment hereunder due but unpaid at the death of the Insured shall be payable, provided there be no assignee entitled thereto, to the person who at the date of payment is the one designated to receive the first payment on account of the proceeds of this policy, if there be such a person living at said date, or, if there be no such person then living, to the Insured's executors or administrators.

Any premiums so waived and any Disability Income so paid shall not be deducted from any other amount payable in any settlement of this policy. Any dividends which would otherwise have become payable during Total Disability shall be allowed as though Total Disability had not occurred.

DEFINITION. Disability is total when it prevents the Insured from engaging in any occupation for remuneration or profit.

The entire and irrecoverable loss of sight of both eyes, or the severance of both hands at or above the wrists, or of both feet at or above the ankles, or such severance of one entire hand and one entire foot, shall be deemed Total Disability hereunder.

Disability resulting directly or indirectly from military or naval service in time of war or from self-inflicted injury are risks not assumed by the Society under this provision.

NOTICE OF CLAIM. Written notice of claim hereunder must be received at the Home Office of the Society during the lifetime of the Insured and the continuance of such Total Disability. Failure to give notice as herein provided shall not invalidate any Total Disability claim if it shall be shown not to have been reasonably possible to give such notice and that written notice was given as soon as was reasonably possible.

PROOF OF TOTAL DISABILITY. Due proof of such Total Disability must be received at the Home Office of the Society while this policy is in force or before the expiration of one year after default in the payment of premium, or if there be no default, not later than one year from the maturity of this policy.

The entire and irrecoverable loss of sight of both eyes, or the severance of both hands at or above the wrists, or of both feet at or above the ankles, or such severance of one entire hand and one entire foot, shall be deemed Total Disability hereunder.

Disability resulting directly or indirectly from military or naval service in time of war or from self-inflicted injury are risks not assumed by the Society under this provision.

NOTICE OF CLAIM. Written notice of claim hereunder must be received at the Home Office of the Society during the lifetime of the Insured and the continuance of such Total Disability. Failure to give notice as herein provided shall not invalidate any Total Disability claim if it shall be shown not to have been reasonably possible to give such notice and that written notice was given as soon as was reasonably possible.

PROOF OF TOTAL DISABILITY. Due proof of such Total Disability must be received at the Home Office of the Society while this policy is in force or before the expiration of one year after default in the payment of premium, or if there be no default not later than one year from the maturity of this policy.

TOTAL DISABILITY COMMENCING DURING GRACE. If due proof furnished as required above shall establish that such Total Disability commenced during the grace of a premium in default, Disability benefits shall be allowed as if such default had not occurred, upon payment of the premium in default with interest thereon at 5% per annum.

RECOVERY FROM TOTAL DISABILITY. The Society shall have the right at any time during the first two years after receipt of such proof, and thereafter once a year, to require proof of the continuance of such Total Disability. If satisfactory proof is not furnished, or if it appears at any time that such Total Disability has terminated, no further premiums will be waived and no further Disability Income payments will be made on account of such Total Disability.

DOUBLE INDEMNITY FOR DEATH FROM ACCIDENT.

Upon receipt of due proof of the Insured's death from accident as defined below, occurring while this policy was in force and no premium hereunder in default, the Society agrees to increase the face amount to the amount stated on the first page hereof.

Death from accident means death resulting solely from bodily injuries caused directly, exclusively and independently of all other causes by external, violent and purely accidental means and ensuing within 90 days of such injuries, but does not include death resulting from or caused directly or indirectly by self-destruction sane or insane, the taking of any poison or the inhaling of any gas, whether voluntary or otherwise, disease or illness of any kind, physical or mental infirmity, military or naval service in time of war, riding as a passenger or otherwise in an airplane or in any other type of aircraft, or by the Insured's violation of any law. The Society, in order to determine whether death resulted from accident, shall, in the absence of legal prohibition, have the right and opportunity to make an autopsy.

Upon any anniversary of the Register date of this policy either or both of the foregoing Disability and Double Indemnity provisions may be discontinued by returning this policy to the Society for proper endorsement, with a written request satisfactory to the Society, and thereafter the payment of the premium for any such discontinued provision shall not be required. In no event shall a premium be charged for the Disability provision on or after the anniversary of such Register date upon which the Insured's age at nearest birthday is 60 years.

PROVISIONS RELATING TO LOANS AND SURRENDER VALUES.

LOANS. After two full years' premiums have been paid, the Society, at any time while this policy is in force, will advance to the Insured, on proper assignment of this policy and on the sole security hereof, at 6% interest per annum payable annually on the premium anniversary date a sum which, with interest for the then current policy year, shall not exceed the cash value as stated in the following table. Interest if not paid when due shall be added to the existing loan and bear interest at the same rate. If the advance is for a purpose other than to pay premiums on policies in the Society, the granting of the same may be deferred by the Society for a period not exceeding ninety days after receipt of application therefor. Failure to repay such advance or to pay interest thereon shall not avoid this policy unless the total indebtedness hereon shall equal the total loan value, nor until thirty-one days after notice shall have been mailed to the Insured, and to the assignee of record, if any, at their addresses last known to the Society.

Such advance may be repaid at any time prior to default in the payment of any premium while this policy is in force.

OPTIONS ON SURRENDER OR LAPSE. Within three months after default in the payment of any premium after two full years' premiums have been paid, the Insured may surrender this policy and elect one of the following Options:

- (a) To receive the cash value of this policy; or
- (b) To purchase non-participating paid-up Endowment insurance payable at the same time and on the same conditions as this policy, but without Disability or Double Indemnity benefits; or
- (c) To continue the insurance as non-participating paid-up extended term insurance for its face amount (and any dividend additions) for the period shown in the opposite table, or for such further period as the dividend additions (if any) will purchase, but without the right to loans, or Disability or Double Indemnity benefits; and if the sum applicable to the purchase of such term insurance shall be more than sufficient to continue the insurance to the end of the endowment period named herein the excess shall be used to purchase a non-participating paid-up pure Endowment payable at the date of the maturity of the Endowment, if the Insured is then living, and on the same conditions as this policy, but without the right to loans, or Disability or Double Indemnity benefits.

TABLE OF LOAN AND SURRENDER VALUES.						
After policy has been in force Years	FOR EACH \$1000 OF FACE AMOUNT.		PAID-UP EXTENDED TERM INSURANCE IRRESPECTIVE OF FACE AMOUNT.		PAID-UP PURE ENDOWMENT FOR EACH \$1000 OF FACE AMOUNT OF POLICY.	
	CASH VALUE.	PAID-UP ENDOWMENT INSURANCE.	Years	Mos.		
2	\$ 50	\$ 61	5	10	\$ 0	END. 20
3	\$ 92	\$ 145	10	10	\$ 0	
4	\$ 133	\$ 203	15	3	\$ 0	
5	\$ 175	\$ 263	15	0	\$ 75	
6	\$ 216	\$ 317	14	0	\$ 154	FOR AGE 35
7	\$ 262	\$ 371	13	0	\$ 236	
8	\$ 303	\$ 429	12	0	\$ 313	
9	\$ 357	\$ 484	11	0	\$ 388	
10	\$ 407	\$ 533	10	0	\$ 459	
11	\$ 456	\$ 587	9	0	\$ 524	

(c) To continue the insurance as non-participating paid-up extended term insurance for its face amount (and any dividend additions) for the period shown in the opposite table, or for such further period as the dividend additions (if any) will purchase, but without the right to loans, or Disability or Double Indemnity benefits; and if the sum applicable to the purchase of such term insurance shall be more than sufficient to continue the insurance to the end of the endowment period named herein the excess shall be used to purchase a non-participating paid-up pure Endowment payable at the date of the maturity of the Endowment, if the Insured is then living, and on the same conditions as this policy, but without the right to loans, or Disability or Double Indemnity benefits.

If the Insured does not elect one of said Options within three months after such default, the insurance shall be continued as provided under Option (c).

Any indebtedness against this policy on or after the date of default shall not be repayable in cash, but the cash value shall be reduced by the amount of such indebtedness plus interest thereon, and the paid-up Endowment insurance shall be for such an amount as the reduced cash value will purchase, and the extended term insurance shall be for the face amount of this policy and dividend additions less such indebtedness and interest and, subject to the provisions of Option (c), for such period as the reduced cash value will purchase, not extending beyond the maturity of the Endowment.

The Insured's right to assign, terminate or change this policy shall extend to any paid-up insurance accruing hereunder.

The payment of any cash value under this policy may be deferred by the Society for a period not exceeding ninety days after receipt of application therefor.

BASIS OF COMPUTATION. The RESERVE for which funds are to be held upon this policy shall be computed upon the American Experience Table of Mortality with interest at 3% by the net level premium method.

The values stated in the opposite table are mathematical equivalents and each is equal to the full RESERVE at the end of the then current policy year, on the basis of annual premiums, less a surrender charge of not more than 2% of the face of this policy until the completion of the tenth policy year, at which time and thereafter there is no deduction made as a surrender charge, except that fractions of a month and fractions of a dollar are not allowed.

2	\$ 50	\$ 61	5	10	\$ 0
3	\$ 92	\$ 145	10	10	\$ 0
4	\$ 133	\$ 205	15	3	\$ 0
5	\$ 175	\$ 263	15	0	\$ 75
6	\$ 216	\$ 317	14	0	\$ 154
7	\$ 262	\$ 371	13	0	\$ 236
8	\$ 303	\$ 429	12	0	\$ 313
9	\$ 357	\$ 484	11	0	\$ 388
10	\$ 407	\$ 533	10	0	\$ 459
11	\$ 456	\$ 597	9	0	\$ 524
12	\$ 508	\$ 636	8	0	\$ 586
13	\$ 561	\$ 684	7	0	\$ 646
14	\$ 616	\$ 731	6	0	\$ 703
15	\$ 674	\$ 777	5	0	\$ 758
16	\$ 733	\$ 823	4	0	\$ 811
17	\$ 796	\$ 868	3	0	\$ 861
18	\$ 861	\$ 913	2	0	\$ 909
19	\$ 928	\$ 956	1	0	\$ 956
20	\$1000	--H A T U R E S--			

END.
20

FOR
AGE
35

The loan value is the cash value less interest to the end of the policy year. The loan obtainable at the end of a given year may be secured during that year if the premium for the entire year has been paid. Due allowance will be made for any fractional premium paid beyond completed policy years.

These values will be increased by the cash value of dividend additions, if any; they will be reduced if there is any indebtedness.

Loan and surrender values for any years not shown in the table will be on the same basis and will be furnished on request.

ASSIGNMENTS. No assignment of this policy shall be binding upon the Society or be deemed to be in force unless in writing and until filed at its Home Office. The Society assumes no responsibility for the validity of any assignment.

BENEFICIARY. If there is no written assignment of this policy in force and on file with the Society or if the only assignment in force and on file is to the Society as security for an advance, the Insured may from time to time, by written notice duly filed at the Society's Home Office, change the beneficiary, but such change shall take effect only upon its endorsement on this policy by the Society.

If the executors or administrators of the Insured be not expressly designated as beneficiary, any part of the proceeds of this policy with respect to which there is no designated beneficiary living at the death of the Insured prior to the maturity of the Endowment and no assignee entitled thereto, will be payable in a single sum to the children of the Insured who survive the Insured, in equal shares, or should none survive, then to the Insured's executors or administrators.

The Insured (or assignee if any) may, without the consent of the beneficiary, surrender, assign or pledge this policy and all rights hereunder or, subject to the Society's approval, change to another form or plan of insurance. An assignment by the Insured shall operate to exclude any and all rights of any beneficiary under this policy except that upon release of all outstanding assignments or upon reassignment to the Insured all rights under this policy shall be the same as if such assignments of said policy had not been made and that if assigned or pledged as collateral only by the Insured any equity remaining at the death of the Insured prior to the maturity of the Endowment shall accrue to the beneficiary.

PAYMENT OF PREMIUMS. All premiums are payable in advance on or before their respective due dates at the Home Office or to any duly authorized Collecting Agent or Cashier of the Society, upon delivery of a receipt signed by the President, a Vice-President, Secretary or Treasurer, and countersigned by said Collecting Agent or Cashier. Subject to the Society's written approval, premiums may be made payable annually, semi-annually or quarterly at the Society's adopted rates for such premiums.

The first policy year under this policy shall begin on the Register date stated on the back of this policy and the second and subsequent policy years shall begin on the respective anniversaries of the Register date.

GRACE. A grace of thirty-one days will be granted for the payment of every premium after the first, during which period the insurance hereunder shall continue in force. No interest will be charged upon premiums paid during the days of grace. If death occur within the days of grace, the premium then due and unpaid shall be deducted from the amount payable hereunder.

LAPSE AND REINSTATEMENT. Failure to pay any premium on or before the day on which it falls due shall constitute a default hereunder. Upon default this policy shall lapse and the insurance herein cease, except as stated in the provisions hereof entitled "Grace" and "Options on Surrender or Lapse," but it may be reinstated at any time unless the cash value has been duly paid or the period of extended term insurance has expired, upon the production of evidence of insurability satisfactory to the Society and the payment of all overdue premiums, with interest at 5% per annum, and upon the payment with interest or the reinstatement of any indebtedness to the Society secured hereby.

AGE. If the age of the Insured has been misstated, any benefits accruing under this policy shall be adjusted

PAYMENT OF PREMIUMS. All premiums are payable in advance on or before their respective due dates at the Home Office or to any duly authorized Collecting Agent or Cashier of the Society, upon delivery of a receipt signed by the President, a Vice-President, Secretary or Treasurer, and countersigned by said Collecting Agent or Cashier. Subject to the Society's written approval, premiums may be made payable annually, semi-annually or quarterly at the Society's adopted rates for such premiums.

The first policy year under this policy shall begin on the Register date stated on the back of this policy and the second and subsequent policy years shall begin on the respective anniversaries of the Register date.

GRACE. A grace of thirty-one days will be granted for the payment of every premium after the first, during which period the insurance hereunder shall continue in force. No interest will be charged upon premiums paid during the days of grace. If death occur within the days of grace, the premium then due and unpaid shall be deducted from the amount payable hereunder.

LAPSE AND REINSTATEMENT. Failure to pay any premium on or before the day on which it falls due shall constitute a default hereunder. Upon default this policy shall lapse and the insurance herein cease, except as stated in the provisions hereof entitled "Grace" and "Options on Surrender or Lapse," but it may be reinstated at any time unless the cash value has been duly paid or the period of extended term insurance has expired, upon the production of evidence of insurability satisfactory to the Society and the payment of all overdue premiums, with interest at 5% per annum, and upon the payment with interest or the reinstatement of any indebtedness to the Society secured hereby.

AGE. If the age of the Insured has been misstated, any benefits accruing under this policy shall be adjusted to correspond to those which would accrue under a similar policy which the premium paid would have purchased at the Society's rates in use at the Register date hereof for the Insured's correct age. The Society will, however, admit the age of the Insured if furnished with due proof thereof, and in that event will issue to the Insured without cost a certificate evidencing such admission.

THE CONTRACT. This policy, and the application therefor, a copy of which is endorsed hereon or securely attached hereto, constitute the entire contract between the parties. All statements made by the Insured shall, in the absence of fraud, be deemed representations and not warranties, and no statement shall avoid this policy or be used in defense of a claim hereunder unless contained in the written application therefor and a copy of such application is endorsed hereon or attached hereto, when issued.

SELF-DESTRUCTION. Self-destruction sane or insane, within one year from the date of issue hereof, is a risk not assumed by the Society under this policy. In such an event the Society's liability shall be limited to an amount equal to the premium actually paid.

MODES OF SETTLEMENT AT MATURITY OF POLICY.

In lieu of the lump sum payment provided for on the first page hereof the Insured may elect to have the net sum due hereunder at the maturity of the Endowment or at his prior death applied under one or more of the following optional modes of settlement, or, in the event of the Insured's death prior to the maturity of the Endowment the beneficiary may so elect in the absence of such an election by the Insured.

If the Insured elects to have the amount payable hereunder at the maturity of the Endowment applied in accordance with one of said modes of settlement, he may nominate (with the right to change such nomination) the person who, in the event of the Insured's death after the maturity of the Endowment, shall receive any amount then remaining unpaid.

The Insured's nominee (if the Insured dies after the maturity of the Endowment) or the beneficiary (if the Insured dies before such maturity) may after the Insured's death designate (with the right to change such designation) the person to receive any amount remaining unpaid at the death of such nominee or beneficiary, as the case may be, if there be no such person designated by the Insured and surviving.

Any such election, designation, nomination or request for change shall be in writing and shall not take effect until filed with the Society at its Home Office and endorsed upon the policy or the supplementary contract, if any.

1. **DEPOSIT OPTION:** Left on deposit with the Society at interest guaranteed at the rate of 3% per annum, with such Excess Interest Dividend as may be apportioned.
2. **INSTALLMENT OPTION:** Paid in a fixed number of equal annual, semi-annual, quarterly or monthly instalments as set forth in the following table.
FIXED PERIOD.
3. **LIFE INCOME OPTION:** Paid in equal annual, semi-annual, quarterly or monthly instalments for five, ten or twenty years certain as may be elected and continuing during the remaining lifetime of the beneficiary as shown in the following table.
4. **INSTALLMENT OPTION:** Paid in equal annual, semi-annual, quarterly or monthly instalments of such amount as may be agreed upon until the net sum due under this policy together with interest on the unpaid balances at the rate of 3% per annum, and such Excess Interest Dividends as may be apportioned, shall be exhausted, the final payment to be the balance then remaining with the Society. If the interest and Excess Interest Dividend for any year shall be in excess of the instalments payable in such year, then the total amount of the instalments for the subsequent year shall be increased by the amount of such excess.

EXCESS INTEREST DIVIDEND: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of instalment under Option 2, the amount of income during the fixed period of five, ten or twenty years under Option 3 and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society.

TABLE OF INSTALMENTS FOR EACH \$1,000 OF PROCEEDS.

The semi-annual and quarterly instalments are 50.37% and 25.28% respectively of the annual instalment under Option 2, and not less than these respective percentages under Option 3.

OPTION 2				OPTION 3—LIFE INCOME												
Number of Years' Instalments	Monthly Instalment	Annual Instalment	Age of Beneficiary when first instalment is due	5 Years Certain		10 Years Certain		20 Years Certain		Age of Beneficiary when first instalment is due	5 Years Certain		10 Years Certain		20 Years Certain	
				Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment		Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment
2	\$42.86	\$507.39	10 and under	\$3.81	\$44.85	\$3.75	\$44.21	\$3.58	\$42.20	48	\$5.36	\$62.61	\$5.17	\$60.51	\$4.00	\$54.20
3	28.99	343.23	11	3.83	45.07	3.77	44.41	3.59	42.36	49	5.45	63.63	5.24	61.40	4.65	54.71
4	22.06	261.19	12	3.85	45.30	3.79	44.82	3.61	42.54	50	5.54	64.70	5.32	62.33	4.69	55.94
5	17.91	211.99	13	3.87	45.54	3.81	44.84	3.62	42.71	51	5.64	65.83	5.41	63.30	4.74	55.77
6	15.14	179.22	14	3.89	45.78	3.83	45.07	3.64	42.90	52	5.74	67.02	5.49	64.30	4.78	56.30
7	13.16	155.83	15	3.91	46.03	3.85	45.29	3.65	43.08	53	5.85	68.26	5.58	65.35	4.83	56.84
8	11.68	138.30	16	3.94	46.27	3.87	45.53	3.67	43.27	54	5.97	69.57	5.68	66.44	4.87	57.37
9	10.53	124.69	17	3.96	46.52	3.89	45.76	3.69	43.47	55	6.09	70.95	5.78	67.57	4.92	57.90
10	9.61	113.81	18	3.98	46.77	3.91	45.99	3.70	43.66	56	6.22	72.40	5.83	68.75	4.96	58.43
11	8.86	104.92	19	4.00	47.02	3.93	46.23	3.72	43.87	57	6.35	73.93	5.98	69.98	5.00	58.95
12	8.24	97.53	20	4.02	47.28	3.95	46.48	3.74	44.07	58	6.49	75.53	6.09	71.24	5.05	59.46
13	7.71	91.29	21	4.05	47.55	3.97	46.74	3.76	44.29	59	6.64	77.22	6.21	72.55	5.09	59.96
14	7.26	85.94	22	4.07	47.84	4.00	47.01	3.78	44.52	60	6.80	78.99	6.32	73.91	5.13	60.45
15	6.87	81.32	23	4.10	48.14	4.02	47.29	3.80	44.75	61	6.96	80.85	6.44	75.31	5.17	60.92
16	6.53	77.29	24	4.12	48.45	4.05	47.59	3.82	45.00	62	7.13	82.81	6.57	76.75	5.20	61.37

OPTION 2				OPTION 3—LIFE INCOME												
Number of Years' Instalments	Monthly Instalment	Annual Instalment	Age of Beneficiary when first instalment is due	5 Years Certain		10 Years Certain		20 Years Certain		Age of Beneficiary when first instalment is due	5 Years Certain		10 Years Certain		20 Years Certain	
				Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment		Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment
2	\$42.86	\$507.39	10 and under	\$3.81	\$44.85	\$3.75	\$44.21	\$3.58	\$42.20	48	\$5.36	\$62.61	\$5.17	\$60.51	\$4.60	\$54.20
3	28.99	343.23	11	3.83	45.07	3.77	44.41	3.59	42.36	49	5.45	63.63	5.24	61.40	4.65	54.71
4	22.06	261.19	12	3.85	45.30	3.79	44.62	3.61	42.54	50	5.54	64.70	5.32	62.33	4.69	55.24
5	17.91	211.99	13	3.87	45.54	3.81	44.84	3.62	42.71	51	5.64	65.83	5.41	63.30	4.74	55.77
6	15.14	179.22	14	3.89	45.78	3.83	45.07	3.64	42.90	52	5.74	67.02	5.49	64.30	4.78	56.30
7	13.16	155.83	15	3.91	46.03	3.85	45.29	3.65	43.08	53	5.85	68.26	5.58	65.35	4.83	56.84
8	11.68	138.30	16	3.94	46.27	3.87	45.53	3.67	43.27	54	5.97	69.57	5.68	66.44	4.87	57.37
9	10.53	124.69	17	3.96	46.52	3.89	45.76	3.69	43.47	55	6.09	70.95	5.78	67.57	4.92	57.90
10	9.61	113.81	18	3.98	46.77	3.91	45.99	3.70	43.66	56	6.22	72.40	5.88	68.75	4.96	58.43
11	8.86	104.92	19	4.00	47.02	3.93	46.23	3.72	43.87	57	6.35	73.93	5.98	69.98	5.00	58.95
12	8.24	97.53	20	4.02	47.28	3.95	46.48	3.74	44.07	58	6.49	75.53	6.09	71.24	5.05	59.46
13	7.71	91.29	21	4.05	47.55	3.97	46.74	3.76	44.29	59	6.64	77.22	6.21	72.55	5.09	59.96
14	7.26	85.94	22	4.07	47.84	4.00	47.01	3.78	44.52	60	6.80	78.99	6.32	73.91	5.13	60.45
15	6.87	81.32	23	4.10	48.14	4.02	47.29	3.80	44.75	61	6.96	80.85	6.44	75.31	5.17	60.92
16	6.53	77.29	24	4.12	48.45	4.05	47.59	3.82	45.00	62	7.13	82.81	6.57	76.75	5.20	61.37
17	6.23	73.74	25	4.15	48.77	4.07	47.90	3.84	45.25	63	7.31	84.87	6.70	78.23	5.24	61.80
18	5.96	70.59	26	4.18	49.12	4.10	48.22	3.86	45.51	64	7.51	87.03	6.83	79.75	5.27	62.20
19	5.73	67.78	27	4.21	49.47	4.13	48.56	3.89	45.79	65	7.71	89.31	6.96	81.30	5.30	62.59
20	5.51	65.25	28	4.25	49.85	4.16	48.91	3.91	46.07	66	7.92	91.69	7.09	82.89	5.33	62.94
21	5.32	62.96	29	4.28	50.24	4.19	49.28	3.94	46.37	67	8.14	94.19	7.23	84.50	5.36	63.27
22	5.15	60.91	30	4.32	50.65	4.23	49.66	3.96	46.67	68	8.37	96.81	7.37	86.14	5.38	63.57
23	4.99	59.04	31	4.35	51.08	4.26	50.07	3.99	46.99	69	8.61	99.56	7.51	87.79	5.40	63.84
24	4.84	57.32	32	4.39	51.53	4.30	50.49	4.02	47.32	70	8.86	102.43	7.65	89.46	5.42	64.08
25	4.71	55.75	33	4.43	52.01	4.33	50.93	4.05	47.66	71	9.13	105.41	7.79	91.12	5.44	64.29
26	4.59	54.30	34	4.48	52.50	4.37	51.39	4.08	48.01	72	9.40	108.57	7.93	92.79	5.45	64.48
27	4.47	52.97	35	4.52	53.02	4.42	51.87	4.11	48.38	73	9.69	111.84	8.07	94.44	5.47	64.64
28	4.37	51.74	36	4.57	53.56	4.46	52.38	4.14	48.75	74	9.99	115.25	8.21	96.06	5.48	64.77
29	4.27	50.59	37	4.62	54.13	4.51	52.90	4.17	49.14	75	10.30	118.78	8.34	97.65	5.48	64.88
30	4.18	49.53	38	4.67	54.73	4.55	53.45	4.21	49.54	76	10.62	122.44	8.47	99.21	5.49	64.97
			39	4.73	55.36	4.60	54.03	4.24	49.96	77	10.95	126.22	8.59	100.71	5.50	65.05
			40	4.78	56.02	4.65	54.63	4.28	50.38	78	11.29	130.13	8.71	102.14	5.50	65.11
			41	4.84	56.71	4.71	55.26	4.32	50.82	79	11.64	134.14	8.82	103.51	5.50	65.15
			42	4.91	57.43	4.77	55.91	4.35	51.27	80	12.00	138.25	8.92	104.80	5.51	65.19
			43	4.97	58.19	4.83	56.60	4.39	51.73	81	12.36	142.44	9.02	106.01	5.51	65.21
			44	5.04	58.99	4.89	57.31	4.43	52.20	82	12.73	146.70	9.11	107.12	5.51	65.23
			45	5.12	59.83	4.95	58.06	4.48	52.69	83	13.09	151.00	9.19	108.14	5.51	65.24
			46	5.19	60.71	5.02	58.84	4.52	53.18	84	13.46	155.34	9.26	109.06	5.51	65.25
			47	5.27	61.64	5.09	59.66	4.56	53.68	85	13.83	159.67	9.32	109.89	5.51	65.25
			and over													

* If the fractional year's instalments under Options 2, 3 or 4 or interest payments under Option 1 together with similar payments from any other policy or policies of this Society on the life of the Insured and payable to the same payee on the same dates would amount to less than Ten dollars each, the Society reserves the right to pay annually, or in such manner that the fractional payments shall amount to at least Ten dollars each.

No option of settlement elected by the Insured hereunder can be changed nor can any payment thereunder be commuted, except by the Insured's written order filed with the Society at its Home Office.

Under Options 2, 3 and 4, the first instalment will be due at maturity of the Endowment or upon receipt of due proof of prior death. If Option 3 be elected the Society will require

satisfactory evidence of the age of the person upon whose life the Life Income depends. After the expiration of the period certain, instalments under Option 3 will continue during the lifetime of such person, terminating with the last instalment due prior to the death of such person.

The Society will make each payment under the above Options by check which will require the personal endorsement of the payee as proof of survival. If any such payment depends upon the survival of any person other than the payee, satisfactory proof of due survival of such other person must be furnished the Society at the time of such payment.

Options 1, 3 and 4 shall be available to the beneficiary only if there is a personal beneficiary, i. e., other than a corporation, firm, trustee, etc.

IT IS NOT NECESSARY TO EMPLOY ANY PERSON, FIRM, OR CORPORATION TO COLLECT THE INSURANCE OR SECURE ANY BENEFIT UNDER THIS POLICY.



WRITE DIRECT TO THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, 383 SEVENTH AVENUE, NEW YORK, OR COMMUNICATE WITH THE NEAREST AUTHORIZED AGENT OF THE SOCIETY WHOSE DUTY IT IS TO FACILITATE ALL SETTLEMENTS WITHOUT CHARGE.

THE EQUITABLE LIFE ASSURANCE SOCIETY

20-YEAR ENDOWMENT POLICY.

No. 510000

JOHN DOE

FACE AMOUNT \$1,000

AGE 30

Annual PREMIUM \$ 56.99

Registration date

JANUARY 1, 1933

Insurance payable in 20 years or at prior death.
Double indemnity for fatal accident.
Total and Permanent Disability Benefit:
Waiver of Premiums, Monthly Disability Income.

Premiums payable for 20 years unless dividends applied to shorten premium paying period.
Annual Dividends.

SERIES AD71 A05 D14

Stipulation Exhibit D.

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MODES OF SETTLEMENT AT MATURITY OF POLICY.

The Insured may elect to have the net sum due under this policy upon its maturity applied under one or more of the following optional modes of settlement in lieu of the lump sum provided for on the first page hereof, and in the absence of such an election by the Insured, the beneficiary, after the Insured's death, may so elect. The beneficiary, after the Insured's death, may designate (with the right to change such designation) the person to whom any amount remaining unpaid at the death of the beneficiary shall be paid if there be no such person designated by the Insured and surviving. Such election, designation or request for change shall be in writing and shall not take effect until filed with the Society at its Home Office and endorsed upon the policy or the supplementary contract, if any.

1. **DEPOSIT OPTION:** Left on deposit with the Society at interest guaranteed at the rate of 3% per annum, with such Excess Interest Dividend as may be apportioned.
2. **INSTALLMENT OPTION: FIXED PERIOD.** Paid in a fixed number of equal annual, semi-annual, quarterly or monthly instalments as set forth in the following table.
3. **LIFE INCOME OPTION:** Paid in equal annual, semi-annual, quarterly or monthly instalments for five, ten or twenty years certain as may be elected and continuing during the remaining lifetime of the beneficiary as shown in the following table.
4. **INSTALLMENT OPTION: FIXED AMOUNT.** Paid in equal annual, semi-annual, quarterly or monthly instalments of such amount as may be agreed upon until the net sum due under this policy together with interest on the unpaid balances at the rate of 3% per annum, and such Excess Interest Dividends as may be apportioned, shall be exhausted, the final payment to be the balance then remaining with the Society. If the interest and Excess Interest Dividend for any year shall be in excess of the instalments payable in such year, then the total amount of the instalments for the subsequent year shall be increased by the amount of such excess.

EXCESS INTEREST DIVIDEND: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1; the amount of instalment under Option 2, the amount of income during the fixed period of five or ten or twenty years under Option 3 and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society.

TABLE OF INSTALMENTS FOR EACH \$1,000 OF PROCEEDS.

The semi-annual and quarterly instalments are 50.37% and 25.20% respectively of the annual instalment under Option 2, and not less than these respective percentages under Option 3.

OPTION 2				OPTION 3—LIFE INCOME													
Age of Insured at death	Monthly Instalment	Semi-annual Instalment	Annual Instalment	Age of Insured at death	5 Years Certain		10 Years Certain		20 Years Certain		Age of Insured at death	5 Years Certain		10 Years Certain		20 Years Certain	
					Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment		Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment
2	342.35	684.70	1027.05	10 and over	33.81	344.85	33.75	344.21	33.52	342.20	48	55.35	552.61	55.17	550.51	54.00	534.20
3	28.90	578.00	867.00	11	3.89	45.07	3.77	44.41	3.89	42.38	49	5.45	63.63	5.34	61.40	4.65	54.71
4	25.05	501.00	751.50	12	3.85	45.80	3.79	44.62	3.61	42.54	50	5.54	64.70	5.23	62.33	4.69	55.24
5	17.91	358.20	537.30	13	3.87	45.84	3.81	44.84	3.62	42.71	51	5.64	65.83	5.41	63.30	4.74	55.77
6	15.14	302.80	454.20	14	3.89	45.78	3.83	45.07	3.64	42.90	52	5.74	67.02	5.49	64.30	4.78	56.30
7	12.16	243.20	364.80	15	3.91	46.03	3.85	45.29	3.65	43.05	53	5.85	68.26	5.58	65.35	4.83	56.84
8	11.05	221.00	331.50	16	3.94	46.27	3.87	45.53	3.67	43.27	54	5.97	69.57	5.68	66.44	4.87	57.37
9	10.03	200.60	300.90	17	3.96	46.52	3.89	45.78	3.69	43.47	55	6.09	70.95	5.78	67.57	4.92	57.90
10	9.61	192.20	288.30	18	3.98	46.77	3.91	45.99	3.70	43.66	56	6.22	72.40	5.88	68.75	4.96	58.43
11	8.35	167.00	250.50	19	4.00	47.02	3.93	46.23	3.72	43.87	57	6.35	73.93	5.98	69.98	5.00	58.96

Age of Insured at death	Monthly Instalment	Annual Instalment	Age of Insured at death	5 Years Certain		10 Years Certain		20 Years Certain		Age of Insured at death	5 Years Certain		10 Years Certain		20 Years Certain	
				Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment		Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment	Monthly Instalment	Annual Instalment
2	242.98	2917.36	10 and over	33.31	399.75	33.75	404.21	33.58	402.20	48	35.36	423.61	35.17	420.51	34.60	414.20
3	26.90	322.80	11	3.38	40.57	3.77	44.41	3.59	42.36	49	5.45	65.63	5.24	61.40	4.65	54.71
4	22.96	275.52	12	3.35	40.20	3.79	44.62	3.61	42.54	50	5.54	64.70	5.33	62.33	4.69	55.24
5	17.91	214.92	13	3.37	40.54	3.81	44.84	3.62	42.71	51	5.64	65.83	5.41	63.30	4.74	55.77
6	15.14	179.22	14	3.39	40.78	3.82	45.07	3.64	42.90	52	5.74	67.02	5.49	64.30	4.78	56.30
7	13.16	157.92	15	3.91	46.93	3.85	45.29	3.65	43.08	53	5.85	68.26	5.58	65.35	4.83	56.84
8	11.69	139.28	16	3.94	46.27	3.87	45.52	3.67	43.27	54	5.97	69.57	5.68	66.44	4.87	57.37
9	10.50	124.00	17	3.96	46.52	3.89	45.76	3.69	43.47	55	6.09	70.95	5.78	67.57	4.92	57.90
10	9.61	113.21	18	3.98	46.77	3.91	45.99	3.70	43.66	56	6.22	72.40	5.88	68.73	4.96	58.43
11	8.85	104.92	19	4.00	47.02	3.93	46.23	3.72	43.87	57	6.35	73.93	5.98	69.98	5.00	58.96
12	8.24	97.68	20	4.02	47.28	3.95	46.48	3.74	44.07	58	6.49	75.53	6.09	71.24	5.05	59.49
13	7.71	91.20	21	4.06	47.55	3.97	46.74	3.76	44.29	59	6.64	77.22	6.21	72.55	5.09	59.99
14	7.30	86.94	22	4.07	47.84	4.00	47.01	3.78	44.52	60	6.80	78.99	6.33	73.91	5.13	60.45
15	6.87	81.22	23	4.10	48.14	4.02	47.29	3.80	44.75	61	6.96	80.85	6.44	75.31	5.17	60.92
16	6.55	77.20	24	4.12	48.45	4.05	47.59	3.82	45.00	62	7.13	82.81	6.57	76.75	5.20	61.37
17	6.30	73.74	25	4.15	48.77	4.07	47.90	3.84	45.25	63	7.31	84.87	6.70	78.23	5.24	61.80
18	6.09	70.80	26	4.18	49.12	4.10	48.22	3.86	45.51	64	7.51	87.03	6.83	79.75	5.27	62.20
19	5.78	67.78	27	4.21	49.47	4.12	48.58	3.89	45.79	65	7.71	89.31	6.96	81.30	5.30	62.59
20	5.51	65.20	28	4.25	49.85	4.16	48.91	3.91	46.07	66	7.92	91.69	7.09	82.89	5.33	62.94
21	5.28	62.90	29	4.28	50.24	4.19	49.28	3.94	46.37	67	8.14	94.19	7.23	84.50	5.36	63.27
22	5.15	60.91	30	4.29	50.65	4.23	49.65	3.96	46.67	68	8.27	96.81	7.37	86.14	5.38	63.57
23	4.99	59.04	31	4.35	51.08	4.26	50.07	3.99	46.99	69	8.61	99.56	7.51	87.79	5.40	63.84
24	4.84	57.28	32	4.39	51.53	4.30	50.49	4.02	47.32	70	8.86	102.42	7.65	89.48	5.42	64.08
25	4.71	55.73	33	4.42	52.01	4.32	50.93	4.05	47.66	71	9.12	105.44	7.79	91.12	5.44	64.29
26	4.59	54.20	34	4.45	52.50	4.37	51.39	4.08	48.01	72	9.40	108.57	7.93	92.79	5.45	64.48
27	4.47	52.97	35	4.49	53.02	4.42	51.87	4.11	48.38	73	9.69	111.84	8.07	94.44	5.47	64.64
28	4.37	51.74	36	4.57	53.56	4.46	52.38	4.14	48.75	74	9.99	115.25	8.21	96.06	5.48	64.77
29	4.27	50.50	37	4.62	54.13	4.51	52.90	4.17	49.14	75	10.30	118.78	8.34	97.65	5.48	64.88
30	4.18	49.25	38	4.67	54.72	4.55	53.45	4.21	49.54	76	10.62	122.44	8.47	99.21	5.49	64.97
			39	4.73	55.36	4.60	54.03	4.24	49.96	77	10.95	126.22	8.59	100.71	5.50	65.05
			40	4.78	56.02	4.65	54.63	4.28	50.35	78	11.29	130.13	8.71	102.14	5.50	65.11
			41	4.84	56.71	4.71	55.26	4.32	50.82	79	11.64	134.14	8.82	103.51	5.50	65.15
			42	4.91	57.43	4.77	55.91	4.35	51.27	80	12.00	138.25	8.92	104.80	5.51	65.19
			43	4.97	58.19	4.82	56.60	4.39	51.73	81	12.36	142.44	9.02	106.01	5.51	65.21
			44	5.04	58.99	4.89	57.31	4.43	52.20	82	12.73	146.70	9.11	107.12	5.51	65.23
			45	5.12	59.83	4.95	58.06	4.48	52.69	83	13.09	151.00	9.19	108.14	5.51	65.24
			46	5.19	60.71	5.02	58.84	4.52	53.18	84	13.46	155.34	9.26	109.06	5.51	65.25
			47	5.27	61.64	5.09	59.66	4.56	53.68	85	13.83	159.67	9.32	109.89	5.51	65.25

If the fractional year's instalments under Options 2, 3 or 4 or interest payments under Option 1 together with similar payments from any other policy or policies of this Society on the life of the Insured and payable to the same beneficiary on the same dates would amount to less than Ten dollars each, the Society reserves the right to pay annually, or in such manner that the fractional payments shall amount to at least Ten dollars each.

No option of settlement elected by the Insured hereunder can be changed nor can any payment thereunder be commuted, except by the Insured's written order filed with the Society at its Home Office.

Under Options 2, 3 and 4, the first instalment will be due upon receipt of due proof of death. If Option 3 be elected the Society

will require satisfactory evidence of the age of the person upon whose life the Life Income depends. After the expiration of the period certain, instalments under Option 3 will continue during the lifetime of such person, terminating with the last instalment due prior to the death of such person.

The Society will make each payment under the above Options by check which will require the personal endorsement of the payee as proof of survival. If any such payment depends upon the survival of any person other than the payee, satisfactory proof of due survival of such other person must be furnished the Society at the time of such payment.

Options 1, 3 and 4 shall be available only if there is a personal beneficiary, i. e., other than a corporation, firm, trustee, etc.

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UNITED STATES BOARD OF TAX APPEALS

355

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Nos.
89294 and
93805

Motion.

356

COMES now the respondent, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and moves the Board that the attached Supplementary Stipulation of Facts be received and filed as a part of the evidence in the above-entitled cases, pursuant to leave granted July 7, 1939.

(Signed) J. P. WENCHEL.

J. P. WENCHEL,
Chief Counsel,

Bureau of Internal Revenue.

OF COUNSEL:

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E. O. HANSON, Division Counsel,
T. H. LEWIS, Special Attorney,
Bureau of Internal Revenue.

GRANTED
Aug. 10, 1939

(Signed) CHARLES P. SMITH,
Member.

U. S. Board Tax Appeals.

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UNITED STATES BOARD OF TAX APPEALS

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No.
89294

Docket No.
93805

359

Supplementary Stipulation of Facts.

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, and that for all purposes the following paragraphs shall be considered as having constituted a part of the Stipulation of Facts when the document was filed. (The following paragraphs are numbered to correspond respectively with the numbers of paragraphs in the earlier stipulation which cover related matters.)

III—A

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No part of the taxes and interest paid by the petitioner as stated in paragraph III (of the Stipulation of Facts) has been refunded.

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XXXI-A

The petitioner's liability under its Supplementary Contracts Not Involving Life Contingencies named "Present Value of Amounts Not Yet Due on Supplementary Contracts Not Involving Life Contingencies" carried on its books as stated in paragraph XXXI (of the Stipulation of Facts) was an amount which, if maintained with annual interest increments, would exactly equal petitioner's obligations under such contracts in respect of amounts not yet due at the time of valuation.

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XXXI-B

Of the mean of the "Present Value of Amounts Not Yet Due on Supplementary Contracts Not Involving Life Contingencies" held by the petitioner at the beginning and end of each of the taxable years, the following percentages were the present values of amounts not yet due under the different options set out in Stipulation Exhibit D exercised as indicated:

	1933	1934	
Option 1 exercised by insured	27.52%	28.20%	362
" 2 " " "	15.36%	14.10%	
" 4 " " "	5.12%	4.70%	
" 1 " " beneficiary	42.99%	44.52%	
" 2 " " "	6.76%	6.36%	
" 4 " " "	2.25%	2.12%	
Total	100.00%	100.00%	

XXXII-A

The "guaranteed interest" which was paid by the petitioner in the year it accrued on petitioner's Supplementary Contracts Not Involving Life Contingencies, accrued and was paid as follows under the different options set out in Stipulation Exhibit D, exercised as indicated:

	1933	1934	
Option 1 exercised by insured	\$307,007	\$372,894	363
" 2 " " "	173,983	188,402	
" 4 " " "	57,994	62,801	
" 1 " " beneficiary	480,191	583,244	
" 2 " " "	74,564	80,744	
" 4 " " "	24,855	26,915	
Total	\$1,118,594	\$1,315,000	

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Supplementary Stipulation of Facts.

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XXXIV-A

The "guaranteed interest" which had accrued in prior years on petitioner's Supplementary Contracts Not Involving Life Contingencies and which was paid by petitioner during the taxable years here involved, was all paid under option 1 the provisions of which are set forth in Stipulation Exhibit D.

XXXVII-A

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The excess interest dividends paid by the petitioner on its Supplementary Contracts Not Involving Life Contingencies, accrued and were paid as follows under the different options set out in Stipulation Exhibit D, exercised as indicated:

	1933	1934
Option 1 exercised by insured	\$147,201.05	\$153,820.84
" 2 " " "	82,158.73	76,910.41
" 4 " " "	27,386.24	25,636.80
" 1 " " beneficiary	229,930.32	242,840.53
" 2 " " "	36,158.40	34,691.51
" 4 " " "	12,052.80	11,563.84
Total	\$534,887.54	\$545,463.93

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(Signed) CAMPBELL E. LOCKE.
CAMPBELL E. LOCKE,
Counsel for Petitioner.

(Signed) J. P. WENCHEL (EOH).
J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Dated, August 3, 1939.

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UNITED STATES CIRCUIT COURT OF APPEALS
SECOND CIRCUIT

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,
Petitioner on Review,

vs.

GUT T. HELVERING, Commissioner of
Internal Revenue,
Respondent on Review.

Docket No.
89294

368

Praecipe for Record.

To the Clerk of the United States
Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit copies, duly certified as correct, of the following documents and records in the above entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit heretofore filed by The Equitable Life Assurance Society of the United States, the petitioner on review:

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1. Docket entries of the proceedings before the Board;
2. Pleadings before the Board,
 - (a) Petition, including annexed copy of deficiency letter;
 - (b) Answer to petition;
 - (c) Amended answer to petition;
 - (d) Amendment of petition;

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(e) Second amended answer to petition and answer to amendment of petition;

(f) Reply to amended answer and to second amended answer;

(g) Motion granted August 21, 1939, for leave to file as of date of hearing (May 26, 1939) amendments of petition as theretofore amended;

(h) Amendments of petition as theretofore amended;

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(i) Motion granted August 21, 1939, for leave to file as of date of hearing (May 26, 1939) amendment of reply to amended answer and to second amended answer;

(j) Amendment of reply to amended answer and to second amended answer;

(k) Motion granted August 21, 1939, for leave to file answer to amendments of petition as theretofore amended and that the same stand as filed as supplements to the second amended answer to petition and answer to amendment of petition;

(l) Answer to amendments of petition as theretofore amended (dated, July, 1939);

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3. Opinion and decision of the Board;

4. Petition for review, together with proof of service of notice of filing of petition for review and of service of a copy of the petition for review;

5. Extracts from stipulation of facts filed by the parties as evidence in the cause, including paragraphs numbered I to VI, inclusive, and paragraphs numbered XXXI to XXXVII, inclusive, together with exhibits attached thereto, marked "Stipulation Exhibit A" and "Stipulation Exhibit D", but omitting other paragraphs and exhibits;

Praeceptum for Record.

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6. Motion granted August 10, 1939, that the supplementary stipulation of facts be received and filed as part of the [125] evidence in the case.

7. Extracts from supplementary stipulation of facts filed by the parties as additional evidence in the cause, including paragraphs numbered III-A, XXXI-A, XXXI-B, XXXII-A, XXXIV-A and XXXVII-A, but omitting other paragraphs;

8. All orders extending and enlarging the time for the transmission and delivery of the record herein not included in the record; (not included in record) 374

9. This praecipe.

Dated: November 17, 1941.

CAMPBELL E. LOCKE,
Attorney for Petitioner on Review,
120 Broadway,
New York, N. Y.

Service of a copy of the foregoing praecipe is hereby admitted this 19th day of November, 1941.

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J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

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UNITED STATES BOARD OF TAX APPEALS

WASHINGTON,

THE EQUITABLE LIFE ASSURANCE
SOCIETY OF THE UNITED STATES,

Petitioner,

against

Docket No.
89294

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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Certificate.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 125, inclusive, contained and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 2d day of December, 1941.

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B. D. GAMBLE,

Clerk,

United States Board of Tax Appeals.

UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,
PETITIONER-APPELLANT

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLEE

Consent for the substitution of attorneys

We hereby consent that John L. Grant, of 393 Seventh Avenue, City, County, and State of New York, be substituted in the place and stead of the undersigned Campbell Locke, as attorney for the petitioner-appellant in the above-entitled proceeding, and that an order to that effect may be entered without further notice.

Dated March 4, 1943.

CAMPBELL LOCKE,

Attorney for Petitioner-Appellant,

120 Broadway, New York, N. Y.

THE EQUITABLE LIFE ASSURANCE

SOCIETY OF THE UNITED STATES,

By ALEXANDER MCNEILL, *Secretary.*

STATE OF NEW YORK,

City of New York, County of New York, ss:

On this 4th day of March 1943, before me personally came Alexander McNeill, to me known, who, being by me duly sworn, did depose and say that he resides at 47 Garden Street, Great Neck, Long Island, New York; that he is the Secretary of The Equitable Life Assurance Society of the United States, the corporation described in, and which executed, the above instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation; and that he signed his name thereto by like order.

HENRY M. ENSOR,

Notary Public.

Notary Public, Richmond County. Cert. filed in N. Y. Co. No. 318, Reg. No. 4-E-175. Commission expires March 30, 1944.

At a stated term of the United States Circuit Court of Appeals for the Second Circuit, held at the United States Court House in the City of New York on the 8th day of March 1943.

Present: The Equitable Life Assurance Society of the United States, Petitioner-Appellant vs. Guy T. Helvering, Commissioner of Internal Revenue, Respondent-Appellee.

On reading and filing the annexed consent of Campbell Locke, Attorney for the petitioner-appellant, and of The Equitable Life Assurance Society of the United States, petitioner-appellant, in the above-entitled proceeding, and on motion of Campbell Locke, Attorney for the petitioner-appellant, it is

Ordered, that John L. Grant be, and he hereby is, substituted in the place of Campbell Locke, attorney for the petitioner-appellant in the above-entitled proceeding.

Enter:

D. E. ROBERTS, *Clerk.*

United States Circuit Court of Appeals for the Second Circuit

No. 4—October Term, 1942

(Argued March 11, 1943—Decided July 26, 1943)

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,

PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

RESPONDENT

Petition by The Equitable Life Assurance Society of the United States for a review of a decision of the Tax Court determining that the petitioner overpaid its income taxes for the year 1933 by \$40,175.79, instead of \$182,168.23, as claimed by the taxpayer. Modified.

Before L. HAND, AUGUSTUS N. HAND, and FRANK, Circuit Judges.

Campbell Locke, Attorney for petitioner-appellant; James D. Ewing and John L. Grant, Counsel. Samuel O. Clark, Jr., Assistant Attorney General, for Commissioner of Internal Revenue. Respondent-Appellee; Sewall Key, J. Louis Monarch, and L. W. Post, Special Assistants to the Attorney General, Counsel. AUGUSTUS N. HAND, Circuit Judge:

The question raised by the petition of the taxpayer, Equitable Life Assurance Society, is whether the Tax Court in determining that the taxpayer overpaid its income tax for 1933 by

\$40,175.79 failed to allow various deductions which would have resulted in a determination of a claimed overpayment of \$182,168.23.

The taxpayer is a mutual life insurance company engaged in the business of issuing life insurance and annuity contracts, transacting that business in every state except Texas. More than 50% of its total reserve funds have been held for fulfillment of its life insurance and annuity contracts.

During and prior to the year 1933 the taxpayer issued life insurance policies which gave to the insured and in some cases to the beneficiary, the right to require it to hold the face amount of policies after the date upon which they would otherwise be payable, supplement these amounts with annual increments of interest, and pay out the increased amounts in installments over varying periods of time. The contracts which evidence the exercise of such options under these provisions are known as "Supplementary Contracts," the form of which appears below.¹ When the payments to be made under these contracts are not affected by a life contingency (contracts arising from the exercise of options 1, 2, and 4) they are known as supplementary contracts not involving life contingencies and are thus referred to in the stipulation appearing in the record.

MODES OF SETTLEMENT AT MATURITY OF POLICY

The Insured may elect to have the net sum due under this policy upon its maturity applied under one or more of the following optional modes of settlement in lieu of the lump sum provided for on the first page hereof, and in the absence of such an election by the Insured, the beneficiary, after the Insured's death, may so elect. The beneficiary, after the Insured's death, may designate (with the right to change such designation) the person to whom any amount remaining unpaid at the death of the beneficiary shall be paid if there be no such person designated by the Insured and surviving. Such election, designation, or request for change shall be in writing and shall not take effect until filed with the Society at its Home Office and endorsed upon the policy or the supplementary contract, if any.

1. Deposit Option: Left on deposit with the Society at interest guaranteed at the rate of 3% per annum, with such Excess Interest Dividend as may be apportioned.

2. Installment Option: Fixed Period.—Paid in a fixed number of equal annual, semi-annual, quarterly, or monthly installments as set forth in the following table.

3. Life Income Option.—Paid in equal annual, semi-annual, quarterly or monthly installments for five, ten, or twenty years certain as may be elected and continuing during the remaining lifetime of the beneficiary as shown in the following table.

4. Installment Option: Fixed Amount.—Paid in equal annual, semi-annual, quarterly, or monthly installments of such amount as may be agreed upon until the net sum due under this policy together with interest on the unpaid balances at the rate of 3% per annum, and such Excess Interest Dividends as may be apportioned, shall be exhausted, the final payment to be the balance then remaining with the Society. If the interest and excess Interest Dividend for any year shall be in excess of the installments payable in such year, then the total amount of the installments for the subsequent year shall be increased by the amount of such excess.

Excess Interest Dividend: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of installment under Option 2, the amount of income during the fixed period of five, ten, or twenty years under Option 3 and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society.

No option of settlement elected by the Insured hereunder can be changed nor can any payment thereunder be commuted, except by the Insured's written order filed with the Society at its Home Office.

Under Options 2, 3, and 4, the first instalment will be due upon receipt of due proof of death.

The Tax Court held that these "Supplementary Contract Reserves" were not "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1932,² inasmuch as they represented assets retained to meet the company's liabilities upon insurance policies which had already matured, and not assets held against unmatured policies. The supplementary contracts provided for interest at a guaranteed rate of 3% per annum. They also provided that in any year when the taxpayer declared that funds held thereunder should receive interest in excess of 3%, the payment should be increased for that year by an excess interest dividend as determined and apportioned by the Society.

The Tax Court allowed the taxpayer to deduct these 3% payments in computing its income tax for the years 1933 and 1934 when the options were exercised by beneficiaries but, on the authority of *Penn Mutual Life Insurance Co. v. Commissioner*, 92 F. (2d) 962 (C. C. A. 3), did not allow the deduction when the option was exercised by the insured.

The foregoing allowance of a deduction of 3 per cent was on the theory that, while Section 203 (a) (2) did not apply because the reserve funds were for Supplementary Contracts not Involving Life Contingencies, nevertheless Subdivision (8) of Section (a)³ was applicable in so far as it related to interest paid on supplementary contracts covered by options exercised by the beneficiary. But the Tax Court refused to allow, under Subdivision (8), the deduction of the 3 per cent guaranteed interest where the insured had exercised the option, and of so-called "excess interest dividends" paid in addition to the guaranteed 3 per cent under resolutions of the Board of Directors, on the ground that they were not interest and hence not deductible under Subdivision (8).

The taxpayer claims the deduction of 3¾ per cent of the mean of the reserve funds held at the beginning and end of 1933 and 1934 because of the literal words of Section 203

² SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) General Rule.—In the case of a life insurance company the term "net income" means the gross income less—

1. Reserve Funds.—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3½ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3½ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only.

2. (8). Interest.—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities this title. . . . the interest upon which is wholly exempt from taxation under this title.

(a), the former Regulations of the Treasury Department,* which had for thirteen years expressly permitted the deduction, and long settled practice thereunder, but in *Helvering v. Inter-Mountain Life Ins. Co.*, 294 U. S. 686, 690, the Supreme Court determined that assets reserved by an insurance company against matured, unsurrendered and unpaid coupons attached to its 20-payment life non-participating policies were not "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921 (of which Section 203 (a) (2) of the Act of 1932 is a reenactment) allowing deduction of a percentage of the mean of such reserve funds in computing the net income of life insurance companies. The Treasury thereupon changed the Regulation.⁵ Justice Butler, who wrote the opinion, said (at p. 690):

"As the Act does not permit corporations other than insurance companies to make deductions of the kind here under consideration, 'reserve funds' may not reasonably be deemed to include values that do not directly pertain to insurance."

In the later decision of *Helvering v. Illinois Ins. Co.*, 299 U. S. 88, Justice Butler, citing *Helvering v. Inter-Mountain Life Ins. Co.*, 294 U. S. 686, repeating the court's former view as to the limited scope of the deduction allowed under Section 203 (a) (2) said:

"The phrase 'required by law' includes only reserves that directly pertain to life insurance. Other reserves, even though required by state statutes regulatory of the business authorized to be carried on by life insurance companies, are not included. Under these policies the company's liabilities on account of the investment funds are independent of those attributable to life insurance risks. The right to participate in the investment funds is not dependent upon death of the insured."

In *Helvering v. Oregon Ins. Co.*, 311 U. S. 267, the Supreme Court again dealt with the types of "reserve funds required by law" which are deductible by life insurance companies under Section 203 (a) (2). It adverted to the fact that it had theretofore held in the *Inter-Mountain Life Insurance Case* that "reserves set aside by life insurance companies to protect payment of policy investment purchases cannot be used as the basis for deductions." In *Helvering v. Oregon Ins. Co.* we find no indication of a purpose to depart from the views expressed by Justice Butler in the earlier decisions we have mentioned.

While it may be argued with some plausibility that there is little basis for distinguishing between the investment and the

* Treasury Reg. 62, Art. 681 (1921 Act).

⁵ T. D. 4615, XIV 2 C. B. 310 (1935).

insurance features of such policies as we are dealing with and that every payment to an insurance company has both contingent and investment features, we think the Supreme Court holds that Congress has not given the privilege of deduction to values that have as little relation to contingencies of life insurance as those involved in the Supplementary Contract Reserves under consideration. The reserves here were carried to provide for the payment of matured life insurance policies and not to meet life contingencies. If we are right in supposing that the foregoing represents the holding of the Supreme Court even where the earlier Regulations of the Treasury Department allowed such deductions as are claimed here, it is unnecessary to discuss Regulations 77 promulgated by the Treasury under the Revenue Act of 1932, Art. 971.

Because of the foregoing considerations we think that the Tax Court was right in holding that Section 203 (a) does not allow the deduction claimed. We also think it was right in allowing the deduction of 3 percent interest paid under settlement options exercised by the beneficiaries; but, we think it should also have allowed deductions where the options were exercised by the insured. In disallowing deductions in such cases it relied on *Penn Mut. Life Ins. Co. v. Commissioner*, 92 F. (2d) 962. There the Court of Appeals for the Third Circuit disallowed the deductions on the ground that the obligation to pay was not due. With all proper respect for the decision in *Penn Mut. Life Ins. Co. v. Commissioner*, supra, we are not persuaded that it should make any difference whether the insured or the beneficiary has exercised the option. Upon the death of the policyholder the company became a debtor of the beneficiary in the face amount of the policy, and the additional payments were interest paid or accrued within the taxable year on an indebtedness of the company even though the due date of the indebtedness may have been postponed by the insured. We therefore, hold that the decision of the Tax Court should be modified so as to allow the deduction of the guaranteed interest whether the options were exercised by the insured or the beneficiary.

Last of all, the taxpayer contends that the excess interest payments in 1933 and 1934 were improperly disallowed and that they ought to have been deducted because they were essentially of the nature of interest. The Court of Appeals of the Third Circuit allowed a similar deduction in *Lederer v. Penn Mut. Life Ins. Co.*, 258 Fed. 81; but in *Penn Mut. Ins. Co. v. Commissioner*, 92 F. (2d) 962, 970, held that the additional interest was in the nature of a dividend, and was not

deductible "as interest on indebtedness." On the other hand, the Seventh Circuit held that such excess interest was deductible in *Commissioner v. Lafayette Ins. Co.*, 67 F. (2d) 209 (C. C. A. 7), and the Board allowed a similar deduction in *Jefferson Standard Life Ins. Co.*, 44 B. T. A. 314. While the latter case involved a stock insurance company, a distinction between stock and mutual insurance companies was probably not intended by Congress. See remarks of Senator La Follette, 75 Cong. Rec. 11636. But it seems to us that a payment which may be made or withheld at the will of the directors of the company cannot be regarded as a payment of interest within the strict construction we are bound to adopt in construing an exemption statute. Under Section 163 (c) (6) (B) of the Revenue Act of 1942, Congress provided that:

"All amounts in the nature of interest, whether or not guaranteed, paid within the taxable year on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which did not involve at the time of payment life, health, or accident contingencies are deductible."

Since the foregoing section was enacted it is true that excess interest dividends such as are here involved would be deductible like guaranteed interest. It seems clear that the statute was amended in order to make the excess interest dividends deductible as interest because theretofore they had not come within a strict construction of the statute and had been held by the Third Circuit to be outside its scope.*

The order of the Tax Court is modified so as to allow the deduction of guaranteed interest paid in connection with settlements of options exercised by the insured where they have been disallowed by that court and as thus modified is affirmed.

United States Circuit Court of Appeals, Second Circuit

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 18th day of August, one thousand nine hundred and forty-three.

Present: Hon. LEARNED HAND, Hon. AUGUSTUS N. HAND, Hon. JEROME N. FRANK, Circuit Judges.

* "It is believed that no distinction should be made based on the person choosing the method of payment and that the full amount of the interest paid instead of only the guaranteed interest should be considered as interest paid. The guaranteed interest where the insured exercises the option and the so-called excess interest dividends are in the nature of interest even though they may not come within a strict construction of that term." Senate Finance Committee, Report on Revenue Bill of 1942, 1943-2 P. H. Tax Serv., p. 16,016.

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is modified in accordance with the opinion of this court and, as thus modified, is affirmed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

D. E. ROBERTS, *Clerk.*

By A. M. BELL, *Deputy Clerk.*

[Order for mandate. United States Circuit Court of Appeals: Second Circuit. Filed Aug. 18, 1943. D. E. Roberts, Clerk.]

United States of America, Southern District of New York

I, D. E. Roberts, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 140, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of The Equitable Life Assurance Society of the United States, Petitioner, v. Commissioner of Internal Revenue, Respondent, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 8th day of September, in the year of our Lord one thousand nine hundred and forty-three, and of the Independence of the said United States the one hundred and sixty-eight.

D. E. ROBERTS, *Clerk.*

By A. M. BELL, *Deputy Clerk.*

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed December 20, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, limited to the second question presented by the petition and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(9993)

NOV 17 1943

CHARLES ELMORE CROPLEY

IN THE
Supreme Court of the United States

October Term, 1943

No. **492**

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

PETITION FOR WRIT OF CERTIORARI
AND BRIEF IN SUPPORT THEREOF

JOHN L. GRANT,
Counsel for Petitioner,
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IN THE
Supreme Court of the United States

October Term, 1943.

No.

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of
Internal Revenue,

Respondent.

PETITION FOR WRIT OF CERTIORARI

*To the Honorable, the Chief Justice and the Associate
Justices of the Supreme Court of the United States:*

Your petitioner, The Equitable Life Assurance Society of the United States, respectfully submits its petition for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, modifying, and affirming as modified, a decision of the United States Board of Tax Appeals (now the Tax Court of the United States) concerning the petitioner's income taxes for 1933.

Jurisdiction of the Court.

This application is made pursuant to Section 1141 of the Internal Revenue Code (53 Stat. 164), and Section 240 of the Judicial Code, as amended (43 Stat. 938).

The judgment below was entered August 18, 1943 (R. 134).

Statute Involved.

The statute involved is the Revenue Act of 1932 which provides in part as follows (47 Stat. 223, 224 and 225):

"Sec. 201. Tax on Life Insurance Companies.

(a) Definition. When used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

(b) * * *

Sec. 202. Gross Income of Life Insurance Companies.

(a) In the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) * * *

Sec. 203. Net Income of Life Insurance Companies.

(a) General Rule.—In the case of a life insurance company the term 'net income' means the gross income less—

(2) Reserve Funds.—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies cover-

ing life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of $3\frac{3}{4}$ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

(8) Interest.—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title."

Questions Presented.

1. Is the petitioner's reserve called "Present value of amounts not yet due on supplementary contracts not involving life contingencies" a reserve fund for which a deduction is provided by Section 203 (a) (2) of the Revenue Act of 1932?

2. If the petitioner is not entitled to the reserve deduction claimed, is it entitled to a deduction under Section 203 (a) (8) of the Revenue Act of 1932 in the amount of the "excess interest dividends" paid within the taxable year, pursuant to the provisions of its supplementary contracts not involving life contingencies as well as the deductions allowed below for guaranteed interest paid on such contracts?

Facts.

The petitioner is a mutual life insurance company organized and existing under and by virtue of the laws of the State of New York, having its principal office and place

of business in the City of New York and being engaged in the business of issuing and selling life insurance and annuity contracts. At all times more than 50% of its total reserve funds have been held for fulfillment of its life insurance and annuity contracts (R. 105).

During and prior to the calendar year 1933 the petitioner issued life insurance policies which gave to the insured, and in some cases to the beneficiary, the right to require the petitioner to hold the face amount of the policy after the date upon which it would otherwise be payable, supplement this amount with annual increments of interest, and pay out the increased amount in installments or otherwise over varying periods of time (R. 109, 118A). The contracts which evidence the exercise of such options under these provisions are known as "Supplementary Contracts." When the payments to be made under these contracts are not affected by a life contingency (contracts arising from the exercise of Options 1, 2 and 4) they are known as supplementary contracts not involving life contingencies and are so referred to herein (R. 109).

It has been stipulated:

"To provide for the payment of life policies which had matured and were payable during 1933 and subsequent years under these 'Supplementary Contracts not Involving Life Contingencies' the petitioner carried on its books a liability (which the petitioner contends is a reserve liability) named 'Present Value of Amounts not yet Due on Supplementary Contracts not Involving Life Contingencies,' in the following respective amounts at the beginning and end of the calendar year: \$34,806,201 and \$42,326,682" (R. 109)..

This liability carried on petitioner's books was the amount which, if supplemented with annual interest increments, would exactly equal petitioner's obligations under the Supplementary Contracts Not Involving Life Con-

tingencies, in respect of amounts not yet due at the time of valuation (R. 110, 120). There is no issue in this case as to the fact that the petitioner was required by state statute and regulations to maintain this reserve in the amounts stated, it being stipulated that:

"For the purpose of providing for these obligations, the taxpayer was required to accumulate and maintain this liability by the statutes of the states in which it was then doing business and by the rulings of state officials made pursuant to authority conferred upon them by such statutes, and as so required the petitioner at all times held admitted assets sufficient to provide for this and all other reserves and/or liabilities" (R. 110).

The supplementary contracts provided for interest at the guaranteed rate of 3% per annum. However, they also provided that, in any year when the petitioner declares that funds held thereunder shall receive interest in excess of 3% per annum, the payment shall be increased for that year by an "excess interest dividend" as determined and apportioned by the Society (R. 109, 118A).

The petitioner contends that its liability or reserve designated "Present Value of Amounts Not Yet due on Supplementary Contracts not Involving Life Contingencies" is one of "the reserve funds required by law," with respect to which Section 203 (a) (2) of the Revenue Act of 1932 provides for a deduction.

Solely as an alternative claim, petitioner contends that, if it is not entitled to the reserve deduction claimed, then it is entitled to a deduction under Section 203 (a) (8) for the interest paid on its supplementary contracts, whether the supplementary contract arises from an option exercised by the insured or by the beneficiary, including amounts termed "excess interest dividends" as well as amounts paid as "guaranteed interest."

The court below, affirming the Board, held that the reserve is not one of the "reserve funds required by law" for which a deduction is provided under Section 203 (a) (2), and stated in its opinion (R. 131) that it felt compelled to reach this decision because of the views expressed by Mr. Justice BUTLER in *Helvering v. Illinois Life Insurance Co.*, 299 U. S. 88, and *Helvering v. Inter-Mountain Life Insurance Co.*, 294 U. S. 686, which the court below interpreted as a holding on the part of this Court that deductions are provided only for reserves which are held for contingent obligations.

On brief before the Board the Commissioner conceded that the petitioner is entitled to the alternative deduction, under Section 203 (a) (8), in the amount of guaranteed interest paid on contracts arising from the exercise of Option 1 by either the insured or the beneficiary (R. 81).

The court below affirmed the decision of the Board (a) in allowing such alternative deduction; (b) in allowing the alternative deduction in the amount of guaranteed interest paid on contracts arising from the beneficiary's election of Options 2 and 4; and (c) in disallowing the alternative deduction in the amount of the "excess interest dividends" paid. The court held it error on the part of the Board to disallow the alternative deduction in the amount of guaranteed interest paid on contracts which arose from the insured's election of Options 2 and 4.

Reasons Relied on for the Allowance of the Writ.

1. The Circuit Court of Appeals for the Second Circuit has decided an important question of Federal Law in conflict with *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110; and *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267.

In *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, this Court held that the Commissioner could not amend his Regulations in 1934 and apply them retroactively so

as to require a taxpayer to include in taxable gross income for 1929 gains realized in buying and selling its own stock and bonds, where the Regulations in force from 1920 to 1934, inclusive, provided that such gains were not required to be included in taxable gross income, and the statute was reenacted without change over the period covered by the Regulations.

In *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267, this Court held that where administrative regulations promulgated under every Revenue Act from 1921 through 1932 recognized the right of life insurance companies to take deductions for disability reserves, and where the 1934 reenactment of Section 203 (a) (2) followed thirteen years of administrative regulations and practice under which substantially identical provisions had been so construed and applied that life insurance companies could and did obtain these deductions, the Commissioner could not make those reserves non-deductible by issuing Regulations to that effect in 1935 or by a retroactive amendment of his earlier Regulations.

In the instant case, under the identical statutory provision considered in *Helvering v. Oregon Mutual Life Ins. Co.*, *supra*, the same Regulations there involved, in force from 1921 until 1935, expressly held the reserve here involved, called "Present value of amounts not yet due on supplementary contracts not involving life contingencies," to be one of the reserve funds for which a deduction is provided by the Revenue Acts (*Reg. 62, 65, and 69, Art. 681; Reg. 74 and 77, Art. 971. See: Appendix*); and life insurance companies were instructed by official Form 1120-L, prescribed by the Commissioner for their income tax returns, to take deductions for this reserve. Indeed, this reserve was the first life insurance reserve held to be a "reserve fund" within the meaning of the revenue acts: *Mutual Benefit Life Insurance Co. v. Herold* (1912), 198 Fed. 199, affirmed with a *per curiam* opinion which did not mention this issue. (CCA-3, 1913) 201 Fed. 918, cert. den.

(1913) 231 U. S. 755, construing Act of 1909, Sec. 38 Second (36 Stat. 113). The Regulations in force under the 1913, 1916, 1917 and 1918 Acts all expressly held this reserve to be one of the "reserve funds" for which those Acts provided a deduction. *Reg. 33, Art. 147(d); Reg. 33 (Revised), Art. 240; Reg. 45, Art. 569.* (Set out in Appendix hereto.)

But on February 11, 1935, Regulations were promulgated asserting this reserve to be non-deductible under the 1934 Act, and on December 18, 1935, a Treasury Decision declared that this Regulation applied retroactively to the 1932 and earlier Acts.

In auditing the petitioner's income tax return for 1933, the respondent disallowed the reserve deduction involved herein on the ground that his amended regulation should be given full retroactive effect (R. 29). This is the same retroactive amendment which was held invalid in *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267, and the fundamental reasoning which required the holding in that case that disability reserves are "reserve funds required by law" requires a like holding as to the reserve involved herein.

In *Helvering v. Oregon Mutual Life Insurance Co.*, *supra*, this Court held:

"It seems clear that Congress intended to permit the deduction of reserves based on those policies that make a company a 'life insurance company' under the Act, which, by definition, includes policies of 'combined life, health, and accident insurance'."

By the same definition the Act also includes "annuity contracts" among those policies which make the petitioner a "life insurance company" *Revenue Act of 1932, Sec. 201 (a)*. And by the respondent's own regulations and well established rulings the supplementary contracts herein involved constitute *annuity contracts* within the meaning of that term as used in the Revenue Acts: *Reg. 103, Sec. 19.22*

(b)(2)-2; Reg. 101, 94, 86, Art. 22(b)(2)-2; S. O. 160, II'-2 C. B., Dec. 1924, p. 60; I. T. 2635, XI-2 C. B. Dec. 1932, p. 63. And see *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, Ch. 44, Sec. 44.34, where, with reference to this holding in the *Oregon Mutual* case, it is stated (at p. 156):

"By the same reasoning, it seems that Congress also intended to provide a deduction for the reserve for supplementary contracts, for supplementary contracts, both involving and not involving life contingencies, constitute *annuity contracts* the issuance of which makes a company a 'life insurance company' by statutory definition.

"It has been held consistently that payments received by the beneficiaries under supplementary contracts not involving life contingencies constitute *annuities* within the meaning of that term as used in the revenue acts; and this is in accord with the meaning of the term 'annuities' as long used and understood by the legal profession and by life insurance authorities."

2. The Circuit Court of Appeals for the Second Circuit has rendered a decision in conflict with decisions of other Circuit Courts of Appeals on the same questions.

The decision below is in direct conflict with *Mutual Benefit Life Insurance Co. v. Herold* (1912) 198 Fed. 199, at pp. 213 and 214, aff'd with a *per curiam* opinion which did not mention this issue (CCA-3, 1913) 201 Fed. 918, cert. den. (1913) 231 U. S. 755, which held that the reserve here involved is one of the reserve funds for which a deduction is provided. That case was decided under the Excise Tax Act of 1909 but it is well settled that the "reserve funds" for which that Act provided a deduction are the same reserve funds for which a deduction is provided by the later Acts including the Revenue Act of 1932. See: *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, p. 72.

In the opinion below (R. 133) the Circuit Court, itself, points out that its decision denying this petitioner the alternative deduction claimed for excess interest paid on these contracts is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Commissioner v. Lafayette Life Insurance Co.*, 67 F. (2d) 209.

On this same issue the decision below, as the court notes in its opinion (R. 132), is also in conflict with *Lederer v. Penn Mutual Life Insurance Co.* (CCA-3, 1919) 258 Fed. 81 at p. 92, affirmed on other issues (1920) 252 U. S. 523, which held that excess interest paid on these supplementary contracts (there called "Trust Certificates") constitutes "interest" and not dividends either in the commercial or insurance sense of that term.

There are other conflicts of which this petitioner cannot complain but which indicate that the matter should be settled by this Court. In allowing this petitioner a deduction for guaranteed interest paid under supplementary contracts which arose from options exercised by the insured, the decision below is in conflict with the decisions of the Circuit Court of Appeals for the Third Circuit in *Penn Mutual Life Insurance Co. v. Commissioner* (two cases) 92 F. (2d) 962 and 972, as noted in the opinion below (R. 132); and with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Pan-American Life Insurance Co. v. Commissioner*, 111 F. (2d) 366, affirmed on other issues (1940) 311 U. S. 273.

3. The Circuit Court of Appeals for the Second Circuit has decided an important question of Federal Law which has not been but should be settled by this Court.

Supplementary contracts not involving life contingencies are annuity contracts which are provided for in practically every life insurance policy issued in this country, to effectuate what has been termed "the obvious purpose of life insurance," i. e., to afford protection to the beneficiary for a period of years subsequent to the death of

the insured: Dawson, *The Business of Life Insurance* (1905), p. 241; Huebner, *Life Insurance* (1st ed.), pp. 99 and 100; Magee, *Life Insurance* (1939), pp. 325 to 327, and 464.

Life insurance companies doing business in this country pay out nearly two hundred million dollars a year under these supplementary contracts which constitute the major part of their annuity business.¹

A large number of life insurance companies have suits or claims for refund pending which involve, *in the alternative*, their rights to a deduction for this reserve and their rights to a deduction for guaranteed and excess interest paid under the supplementary contracts for which the reserve is held. Many of these suits and claims have been suspended pending the final outcome of the instant proceeding.

The decision below is not the final answer, for as to each of the issues, as shown above, it is in conflict with either the decisions of this Court or, there being no such decision, with the decisions of the Circuit Courts of Appeals for other Circuits which have passed on such issues.

Life insurance companies are seeking an authoritative answer to the following questions:

- One. Which is the proper deduction for supplementary contracts, the reserve deduction under Section 203 (a) (2) or the deduction for interest paid on indebtedness under Section 203 (a) (8)?
- Two. If the latter is the proper deduction, how shall it be computed?

¹ *Spectator Compendium of Official Life Insurance Reports*, 1941, p. 136 A, where it is shown that payments made during 1940 by 305 life insurance companies under supplementary contracts totalled \$213,400,837; and that all other annuity payments made that year by the same companies amounted to \$142,284,323. While no split up is shown in the total amounts paid as between supplementary contracts involving life contingencies and supplementary contracts not involving life contingencies, the consideration received during the year for each of these types of contracts is shown, and indicates that 85% of the payments made under supplementary contracts were made under those which did not involve life contingencies.

The Commissioner's retroactive amendment of his Regulations has given rise to a number of cases involving these questions. But in each of the cases reaching the Circuit Courts of Appeals for other Circuits, the insurance company abandoned its claim to a reserve deduction in favor of the alternative but larger deduction for both guaranteed and excess interest paid:

Penn Mutual Life Insurance Co. v. Commissioner (CCA-3, 1937) 92 F. (2d) 962;

Penn Mutual Life Insurance Co. v. Commissioner (CCA-3, 1937) 92 F. (2d) 972;

Pan-American Life Insurance Co. v. Commissioner (CCA-5, 1940) 111 F. (2d) 366; affirmed on other issues (1940) 311 U. S. 273.

Accordingly, although various and conflicting decisions have been reached by the Board of Tax Appeals and by the Circuit Courts of Appeals for the Second, Third and Fifth Circuits, on the secondary question as to the proper basis for computing the alternative deduction for interest paid, the instant proceeding is the first case in which a Circuit Court of Appeals has passed upon the primary question as to whether the reserve deduction or the deduction for interest paid, is the proper deduction for supplementary contracts under the 1921 and subsequent Acts.

The court below, though not free from doubt (R. 132), felt compelled to deny the reserve deduction because of certain expressions in opinions rendered by this Court in two cases which had nothing to do with insurance reserves maintained for the protection of insurance beneficiaries: *Helvering v. Inter-Mountain Life Insurance Co.* (1935) 294 U. S. 686; and *Helvering v. Illinois Life Insurance Co.* (1936) 299 U. S. 88.

That the opinions rendered in these two cases need clarification was pointed out in the 1939 *Supplement to Paul*

and *Mertens on the Law of Federal Income Taxation*, at pages 1793, 1795 and 1796, where it is stated:

“The language in those opinions may be clarified if the Supreme Court is called upon to decide whether a life insurance company is entitled to a deduction for its reserve for supplementary contracts.

“The *Inter-Mountain* and the *Continental Assurance Co.* cases can be distinguished on the ground that the funds there involved were of a type expressly excluded from the meaning of the phrase ‘reserve funds required by law’ by the Treasury Regulations. These two cases and the *Illinois Life* case can be distinguished upon the further ground that the funds there involved, unlike the reserve for supplementary contracts, were held for the profit of the policyholders rather than for the protection of the beneficiaries. In an earlier decision the Supreme Court held that Congress in the taxation of life insurance companies provided certain deductions where the element of protection was predominant but that it was not the intent of Congress to provide the same deductions in relation to profits payable to the policyholders. This distinction which has been noted and applied in cases dealing with reserve deductions, may account for the provisions in the Treasury Regulations which prior to 1935 held the reserve for supplementary contracts to be a ‘reserve fund required by law’ while excluding from the meaning of that phrase funds of the type involved in the *Inter-Mountain* case. This distinction may also be the real basis for the decisions in the *Illinois Life*, the *Inter-Mountain* and the *Continental Assurance Co.* cases, and, if this is so, these decisions do not bar a reserve deduction for the reserve for supplementary contracts which is maintained exclusively for the protection of the beneficiaries.”

But for the decision below the questions involved herein would now seem to be settled by the decision of this Court

in *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267, for the fundamental reasoning in that case and the decision therein would seem to reaffirm the right of life insurance companies to a deduction for this reserve. See: the dissenting opinion of Board Members Black and Arundell, below (R. 89); and *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, at pp. 154 *et seq.* And see Note 46, p. 167 of that volume for a discussion of the difficulties in applying, as the court below has done, the deduction for interest paid on indebtedness under Section 203 (a) (8) of the Act instead of the reserve deduction under Section 203 (a) (2); to payments made under these supplementary contracts.

Prayer.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari issue to the United States Circuit Court of Appeals for the Second Circuit commanding said court to certify and send to this Court for its review and determination on a day certain to be named therein, a full and complete transcript of the record and all proceedings in said case, and that said judgment of the United States Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem just; and your petitioner will ever pray.

THE EQUITABLE LIFE ASSURANCE.
SOCIETY OF THE UNITED STATES

By JOHN L. GRANT,
its Attorney,

393 Seventh Avenue,
New York 1, N. Y.

BRIEF IN SUPPORT OF PETITION

Opinions Below.

The opinion of the Circuit Court of Appeals below (R. 128) has not yet been officially reported.

The opinion and the dissenting opinion below (R. 63, 88) of the United States Board of Tax Appeals (now the Tax Court of the United States) are reported in 44 B. T. A. 293 and 312.

Jurisdiction.

The jurisdiction of this Court is set forth in the petition on page 1 above.

Questions Presented.

The questions presented are set forth in the petition on page 3 above.

The Statute and Regulations Involved.

The statute involved is set forth in the petition on pages 2 and 3 above. The Regulations involved are set out in the Appendix.

Facts.

A statement of the case is made in the petition beginning on page 3 above.

Specification of Errors to Be Urged.

1. The Circuit Court of Appeals for the Second Circuit erred in holding that the reserve called "Present value of amounts not yet due on supplementary contracts not involving life contingencies" is not a reserve fund for which a deduction is provided by Section 203(a)(2) of the Revenue Act of 1932 (47 Stat. 224).

2. The said court erred in holding that the excess interest dividends which the petitioner determined and paid during the year 1933 on its supplementary contracts not involving life contingencies, pursuant to the policy provisions under which those contracts arose, does not constitute interest paid on indebtedness within the meaning and intent of Section 203(a)(8) of the Revenue Act of 1932 (47 Stat. 225).

3. The said court erred in failing to hold upon the facts as found by the United States Board of Tax Appeals (now the Tax Court of the United States) that the petitioner is entitled in full to one or the other of the deductions, claimed in the alternative, under Section 203(a)(2) and Section 203(a)(8) of the Revenue Act of 1932 (47 Stat. 224 and 225).

ARGUMENT.

I.

The decision below is in direct conflict with *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110.

In *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, this Court held that the Commissioner could not amend his Regulations in 1934 and apply them retroactively so as to require a taxpayer to include in taxable gross income for 1929 gains realized in buying and selling its own stock and bonds, where the Regulations in force from 1920 to 1934, inclusive, provided that such gains were not required to be included in taxable gross income, and the statute was reenacted without change over the period covered by the Regulations. In that case this Court stated (306 U. S. 110 at pp. 114 and 116):

“The administrative construction embodied in the regulation has, since at least 1920, been uniform with respect to each of the revenue acts from that

of 1913 to that of 1932, as evidenced by Treasury rulings and regulations, and decisions of the Board of Tax Appeals. In the meantime successive revenue acts have reenacted, without alteration, the definition of gross income as it stood in the Acts of 1913, 1916, and 1918. Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law.

"We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.

"Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

In the instant case, under the Corporation Excise Tax Act of 1909, and under each succeeding revenue act, life insurance companies have been provided a deduction for "reserve funds". The Treasury Regulations as issued under every Revenue Act from 1913 to 1932, both included, expressly held that the reserve for supplementary contracts involved herein is one of the "reserve funds" for which deductions were provided by those Acts. *Reg. 33, Art. 147(d)*; *Reg. 33 (revised), Art. 240*; *Reg. 45, and 45 (1920 ed.), Art. 569*; *Reg. 62, 65 and 69, Art. 681*; *Reg. 74 and 77, Art 971* (set out in Appendix).

The Revenue Acts of 1909, 1913, 1916, 1917 and 1918 provided a deduction for *all* insurance companies in the amount of:²

² Sec. 38, Second, Act of 1909 (36 Stat. 113); Sec. 116(b), Act of 1913 (38 Stat. 172, 174); Sec. 12(a) Second, Act of 1916 (39 Stat. 768); Tit. I, Sec. 4, Act of 1917 (40 Stat. 302); Sec. 234(a)(10), Act of 1918 (40 Stat. 1079). Note: In the 1918 Act the words "if any" were omitted and "within the year" was changed to "within the taxable year."

"the net addition, if any, required by law to be made within the year to reserve funds"

The reserve involved herein was the first-life insurance reserve held to be one of the reserve funds for which a deduction was provided by the quoted provision of those five earlier Acts. *Mutual Benefit Life Insurance Co. v. Herold* (1912), 198 Fed. 199 at pages 213 and 214, aff'd with a *per curiam* opinion which did not mention this issue (CCA-3, 1913), 201 Fed. 918, cert. den. (1913), 231 U. S. 755.

The 1918 reenactment of the quoted provision was made in the light of that decision and of *Regulations 33, Art. 147(d)*; and *33 (revised), Art. 240, supra*. Accordingly the Regulations issued under the 1918 Act expressly held (*Reg. 45, Art. 569*):

"In the case of life insurance companies the net addition to the 'reinsurance reserve' and the '*reserve for supplementary contracts not involving life contingencies*,' and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible." (Italics supplied.)

Before enacting the new plan for taxing life insurance companies, subsequently embodied in the Revenue Act of 1932,³ Congress, through its Ways and Means Committee, requested and received a digest of all United States Court decisions under the Internal Revenue Acts from 1909 to 1919 inclusive: *Notes on the Revenue Act of 1918 (Ways and Means Committee, 66th Cong., 1st Sess.) Part I, page 3*. Two of the four cases cited in this digest as dealing with life insurance reserve deductions, dealt with the reserve involved herein; and both of these cases are there cited to the Ways and Means Committee as holding this reserve

³ This plan, embodied in sections 201, 202 and 203 of the 1932 Act (47 Stat. 223) was first enacted in 1921 as sections 242 to 245 of the 1921 Act (42 Stat. 261). See: *National Life Insurance Co. v. U. S.* (1928) 277 U. S. 508.

to be one of the reserve funds for which a deduction was provided by the 1918 and prior Acts.⁴

One of the reasons for enacting the 1921 plan was that the provisions of prior acts applicable to life insurance companies were "imperfect and productive of constant litigation." *House Report No. 350, 67th Cong. 1st Sess., page 14.* Unquestionably the litigation referred to included *Mutual Benefit Life Ins. Co. v. Herold*, 198 Fed. 199. See: *W. Va. and Ky. Ins. Agency v. Comm'r*, 18 B. T. A. 715 at page 723, where the Board of Tax Appeals so states.

It is scarcely conceivable that Congress, desiring to enact provisions that would not be "productive of constant litigation," and having in mind the decision in *Mutual Benefit Life Insurance Co. v. Herold*, *supra*, would have provided a deduction for "reserve funds required by law" with no other limiting provision if, in so doing, it had not intended to again provide a deduction for the reserve for supplementary contracts not involving life contingencies which, in that very case, was held to be one of the "reserve funds" for which the earlier acts had provided a deduction.

The reserve deduction provision of the 1921 Act was reenacted without material change by the Revenue Acts of 1924, 1926, 1928 and 1932.⁵ As already noted, the Regulations as issued under each of these Acts expressly held

⁴ Notes on the Revenue Act of 1918, Part II, p. 33, citing *Mutual Benefit Life Ins. Co. v. Herold* (1912) 198 Fed. 199; and *Northwestern Mutual Life Ins. Co. v. Fink* (1917) 248 Fed. 568.

The *Fink* case was subsequently reversed for failure of proof, 267 Fed. 968 at page 973 (CCA-7, 1920), but the Treasury Department recognized that this reversal was not contrary to the holding in *Mutual Benefit v. Herold*, *supra* and, accordingly, in Regulations issued seven months later, it was again expressly held that this reserve is one for which a deduction was provided by the 1918 Act: Regs. 45 (1920 ed.), Art. 569. And see Mills, *History of the Taxation of Life Insurance Companies Under the Federal Income, Capital Stock, and Excess Profits Taxes, 1909-1940, Temporary National Economic Committee Hearings*, Part 31-A, page 18099 at page 18113.

⁵ Sec. 245(a)(2) of the Revenue Acts of 1924 (43 Stat. 289) and 1926 (44 Stat. 2nd Pt. 47); and Sec. 203(a)(2) of the Revenue Acts of 1928 (45 Stat. 843), and 1932 (47 Stat. 224).

this reserve to be one of the "reserve funds" for which a deduction is provided by those Acts: *Reg. 62, 65, and 69, Art. 681; Reg. 74 and 77, Art. 971* (set out in Appendix).

Not until December, 1935, two years after the close of the taxable year involved herein, did the respondent, by a retroactive amendment of his regulations, attempt to exclude this reserve from the "reserve funds" for which a deduction is provided by the 1932 and prior Acts. *T. D. 4615, C. B. XIV-2, page 310.*

Under the circumstances, we respectfully submit that the decision below upholding the validity of this retroactive amendment of the Regulations, is in direct conflict with the decision of this Court in *Helvering v. R. J. Reynolds Tobacco Co., supra.*

II.

The decision below is in direct conflict with *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267.

The identical provisions of the Revenue Acts, the Regulations and administrative practice thereunder, and the retroactive amendment of those Regulations, which are involved in the instant case, were considered by this Court in *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267. There, holding this retroactive amendment of the Regulations invalid in so far as it attempted to exclude disability reserves from the "reserve funds" for which a deduction is provided by the 1932 Act, this Court said (311 U. S. 267 at pp. 270 and 272):

"It is not disputed that administrative regulations promulgated under every Revenue Act from 1921 through 1932 recognized the right of life insurance companies to take deductions both for death and for disability reserves on policies such as those here involved. Nor is it denied that the 1934 reenact-

ment of section 203(a)(2) followed thirteen years of administrative regulation and practice under which substantially identical provisions had been so construed and applied that life insurance companies could and did obtain these deductions. During that entire period, the Treasury found no ambiguity in section 203(a)(2), and expressed no doubt as to a life insurance company's right to make such deductions. But on February 11, 1935, regulations were promulgated asserting disability reserves to be non-deductible under the 1934 Act; and on December 18, 1935, a Treasury Decision declared that this regulation applied retroactively to the 1932 and earlier Acts. Respondent now says that its former practice in permitting disability reserve deductions was erroneous, and that the new regulation should be given full retroactive effect.

.

We find it unnecessary to discuss the extent to which such a regulation might, under different circumstances, be given retroactive effect by virtue of the statutory power of the Commissioner. . . . For it is our conclusion that by section 203(a)(2) of the 1932 and 1934 Acts, Congress has granted life insurance companies a deduction for disability reserves which only Congress can take away."

What this Court there said with reference to deductions for disability reserves applies with equal force to the reserve deduction involved herein. See the dissenting opinion of Board Members Black and Arundell, below (R. 89).

In the *Oregon Mutual Life* case it was further held that (311 U. S. 267 at p. 270):

"It seems clear that Congress intended to permit the deduction of reserves based on those policies that make a company a 'life insurance company' under the Act, which, by definition, includes policies of 'combined life, health, and accident insurance'."

This same statutory definition includes reserves held for the fulfillment of annuity contracts among the reserves which make a company a "life insurance company" under the Act. 47 Stat. 223, sec. 201(a). And the reserve for "supplementary contracts not involving life contingencies" constitutes the major part of the annuity reserves held by life insurance companies doing business in this country.*

It has been held consistently that payments received by the beneficiaries under supplementary contracts not involving life contingencies constitute annuities within the meaning of that term as used in the revenue acts. It was so held in *Commissioner v. Winslow* (CCA-1, 1940), 113 F. (2d) 418. And see: *Old Colony Trust Co. et al. v. Commissioner*, 37 BTA 435, aff'd (CCA-1, 1939), 102 F. (2d) 380. The Bureau of Internal Revenue has so ruled consistently for nearly twenty years.†

The Commissioner's own definition of the term "annuities" as used in the revenue acts includes the supplementary contracts involved herein: *Reg. 103, Sec. 19.22 (b)(2)-2; Reg. 101, 94, 86, Art. 22(b)(2)-2*; (set out in Appendix). These regulations embody well established rulings of the Bureau issued under the earlier revenue acts. *S. O. 160, III-2 C. B., Dec. 1924, page 60; I. T. 2635, XI-2 C. B., Dec. 1932, page 63.*

The same fundamental reasoning which caused this Court in *Helvering v. Oregon Mutual Life Insurance Co.*, *supra*, to hold that disability reserves are "reserve funds

* *Spectator Compendium of Official Life Insurance Reports*, 1941, p. 136A where it is shown that payments made during 1940 by 305 life insurance companies under supplementary contracts totalled \$213,400,837; and that all other annuity payments made that year by the same companies amounted to \$142,284,323. While no split up is shown in the total amounts paid as between supplementary contracts involving life contingencies and supplementary contracts not involving life contingencies, the consideration received during the year for each of these types of contracts is shown, and indicates that 85% of the payments made under supplementary contracts were made under those which did not involve life contingencies.

† *S. O. 160, III-2 C. B., Dec. 1924, page 60; I. T. 2635, XI-2 C. B., Dec. 1932, page 63; I. T. 3033, XV-2 C. B., Dec. 1936, page 131; I. T. 3402, C. B. 1940-2, page 57; I. T. 3413, C. B. 1940-2, page 58; G. C. M. 21666, C. B. 1940-1, page 116; G. C. M. 22519, C. B. 1941-2, page 330.*

required by law" for which a deduction is provided by the 1932 Act, requires a like holding as to the reserve involved herein; and the decision below denying a deduction for this reserve is, therefore, in direct conflict with the decision of this Court in that case. See: *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, p. 154, *et seq.*

III.

The decision below is in direct conflict with decisions of other Circuit Courts of Appeals on the same matter.

The decision below, holding that the reserve for Supplementary Contracts Not Involving Life Contingencies is not a "reserve fund" for which a deduction is provided by the Revenue Acts, is in direct conflict with *Mutual Benefit Life Insurance Co. v. Herold* (1912), 198 Fed. 199 at pp. 213 and 214, *aff'd* with a *per curiam* opinion which did not mention this issue (CCA-3, 1913) 201 Fed. 918, *cert. den.* (1913) 231 U. S. 755.

On the alternative issue involving a deduction for excess interest paid by the petitioner on its supplementary contracts, the decision below is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Lafayette Life Insurance Co. v. Commissioner* (CCA-7, 1933), 67 F. (2d) 209. This conflict is noted by the court in its opinion below (R. 133).

On the same alternative issue the decision below, as noted by the court in its opinion (R. 132), is also in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Lederer v. Penn. Mutual Life Insurance Co.* (CCA-3, 1919) 258 Fed. 81 at p. 92, *aff'd* on other issues, 252 U. S. 523. In that case the question was squarely

presented whether the excess interest paid by a mutual life insurance company on its supplementary contracts, there called "Trust Certificates," constitutes interest or dividends. The undisputed testimony in that case shows that the payments there held to constitute not *dividends* but *interest* and therefore held to be deductible was excess interest over and above any guaranteed rate. See: p. 57 of the Transcript of the Record in *Penn Mutual Life Ins. Co. v. Lederer* (Oct. Term, 1919, No. 499), 252 U. S. 523.

IV.

In reaching its decision the court below misconstrued the opinions rendered in *Helvering v. Inter-Mountain Life Insurance Co.*, 294 U. S. 686, and *Helvering v. Illinois Life Insurance Co.*, 299 U. S. 88; and nothing said or held in those cases by this Court can properly be construed as barring a deduction for this reserve.

The court below felt compelled (R. 131) to reach its decision denying the reserve deduction involved herein because of certain remarks of Mr. Justice BUTLER in the opinions in *Helvering v. Inter-Mountain Life Insurance Co.*, 294 U. S. 686; and *Helvering v. Illinois Life Insurance Co.*, 299 U. S. 88.

But in neither of those cases was the reserve for "supplementary contracts not involving life contingencies" considered by this Court. In each of those cases the reserve deduction was claimed for a fund maintained for the profit of certain *policyholders*, a fund which was not held for *insurance obligations* contingent or otherwise. See *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267 at p. 271, where this Court said with reference to those decisions:

"But those decisions rested upon the conclusion that the investment fund features had no relation to the insurance risks."

Neither of those decisions, therefore, bars a deduction for the reserve here involved, which is maintained solely for the protection of *insurance beneficiaries* in fulfillment of the *life insurance obligations* of the petitioner (R. 109, 118A and 120). See *1939 Supplement to Paul and Mertens on the Law of Federal Income Taxation*, pages 1793 to 1796.

The remarks of Mr. Justice BUTLER in the *Inter-Mountain* and *Illinois Life* opinions, with reference to reserve deductions for contingent liabilities, can properly be construed only in the light of the cases which gave rise to the "contingency" test or rule barring reserve deductions for most accrued or absolute liabilities. That rule or test was derived from cases decided under the 1918 and prior Acts which included premium receipts in the gross income of *all* insurance companies. *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) vol. 2, §§ 44.28, 44.30 and 44.32.

The sole purpose of the reserve deduction under those earlier acts was to postpone the taxation of premium receipts until "earned": *Utah Home Fire Insurance Co. v. Commissioner*, 64 F. (2d) 763 (CCA-10, 1933), cert. den. 290 U. S. 679, 78 L. Ed. 586, 54 S. Ct. 103 (1933); *Commissioner v. Dallas Title & Guaranty Co.*, 119 F. (2d) 211 (CCA-5, 1941); *Union Underwriters of New York, et al.*, 4 BTA 472. And see: *Massachusetts Protective Assn., Inc. v. United States*, 114 F. (2d) 304 (CCA-1, 1940); *Travelers Equitable Insurance Co.*, 22 BTA 784. Quite obviously those acts provided a deduction only for *unearned* premium reserves. Accrued or absolute insurance liabilities which are *due and payable* do not constitute *unearned* premium reserves for such liabilities are always payable from *earned*

premiums. As a general rule, therefore, a deduction was provided by the 1918 and earlier acts only for reserves which represent contingent liabilities, and under those acts the "contingency" test or rule barring reserve deductions for most accrued or absolute liabilities was a valid aid in determining reserve deductions.

But one of the well recognized exceptions to the "contingency" test under the acts in force when that test was formulated, was the reserve for supplementary contracts not involving life contingencies. This reserve was expressly held both by the courts and by the regulations, to be one of the reserve funds for which a deduction was provided by the 1909, 1913, 1916, 1917 and 1918 Acts. (As shown under Point I, *ante*.) And this holding was proper because this reserve is held for benefits which are *not* yet due and payable (R. 120), and represents the unearned portion of the consideration received for the issuance of these contracts. See *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) vol. 8, p. 162 and notes.

Under the 1921 and subsequent acts, including the Revenue Act of 1932, premium receipts are not included in the gross income of life insurance companies and the reserve deduction provided for such companies has nothing to do with "earned" or "unearned" premiums. Under the provisions of these later acts, therefore, it would seem that the reason for the rule barring reserve deductions for accrued or absolute liabilities of a life insurance company, no longer exists.

Quite aside from this fact, however, it is obvious that the remarks of Mr. Justice BUTLER in the *Inter-Mountain* and *Illinois Life* opinions, which appear to express approval of this test or rule, cannot properly be construed to bar a deduction under these later Acts for a reserve which was not considered by the Court in those cases and which was consistently and properly recognized as an

exception to the rule under the very Acts which were in force when the rule was formulated. *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) §§ 44.32 and 44.34.

V.

The decision below, denying the reserve deduction involved herein, is contrary to the general legislative purpose of providing the reserve deduction and contrary to the specific legislative purpose of providing that deduction at a fixed statutory rate.

The general legislative purpose of providing the reserve deduction is to exempt from tax that part of a life insurance company's investment income which must be used to provide for the company's insurance obligations: *Finance Committee Report on the Revenue Bill of 1932*, S. Rept. No. 665, 72nd Cong. 1st Sess., at pp. 35 and 36; and see the dissenting opinion of Mr. Justice BRANDEIS in *National Life Insurance Co. v. United States*, 277 U. S. 508 at p. 525.

Supplementary Contracts Not Involving Life Contingencies are life insurance obligations. They constitute annuities provided for in practically all life insurance policies to effectuate what has been termed "the obvious purpose of life insurance," i. e., to afford protection to the beneficiary for a period of years subsequent to the death of the insured: Dawson, *The Business of Life Insurance* (1905), p. 241; Huebner, *Life Insurance* (1st ed.), pp. 99 and 100; Magee, *Life Insurance* (1939) pp. 325 to 327, and 464.

Just as the company is obligated prior to the death of policyholders to increase the reserve funds held for their policies at a specified rate from its gross investment income, so the company is obligated, after the death of the

policyholders, to add such increments of interest to the reserve funds held for the supplementary contracts arising out of those policies, and to pay the principal amount of such funds together with such increments of interest to the beneficiaries of such contracts in accordance with the terms thereof (R. 118, 120, 110). See Magee, *Life Insurance* (1939 ed.), pages 327, *et seq.*

In carrying out the general purpose of the Act, therefore, a deduction is just as necessary for this reserve as for any other life insurance or annuity reserve.

Furthermore, the specific legislative purpose of providing the reserve deduction at a fixed statutory rate rather than at the various rates *assumed or guaranteed* by different companies in calculating their reserves, requires the allowance for this reserve of the deduction provided by section 203(a)(2) of the 1932 Act for "reserve funds required by law."

In reporting the Revenue Bill of 1932 the Senate Finance Committee recommended that the reserve deduction be provided at the rates actually used by the different companies in calculating their reserves. This would have given a decided advantage to stock companies over mutual companies because the latter generally calculate their reserves at an *assumed or guaranteed* rate of 3% while stock companies, paying neither dividends nor excess interest, assume or guarantee a reserve earning of 3½% to 4%. *75 Cong. Rec. 11636 to 11647.*

It was to prevent such discrimination against mutual companies that the Senate rejected the Finance Committee's recommendation and Congress enacted the reserve deduction at a fixed rate as phrased by the LaFollette amendment. *75 Cong. Rec. 11636 to 11647.*

For a discussion of the LaFollette Amendment and of the reasons for its adoption, with particular reference to the reserve here involved, see: *Mertens on the Law of*

Federal Income Taxation (Callaghan & Co., 1942), Vol. 8, pp. 162 to 166, where it is stated (at p. 164):

"To carry out this legislative purpose, it would seem just as necessary to allow a deduction at the fixed statutory rate for the reserve for supplementary contracts not involving life contingencies as for any other life insurance reserve. The issuance of supplementary contracts constitutes a large and increasing part of the business of life insurance. They are provided for in the policies of both mutual and stock companies and the guaranteed rates of interest upon which payments made under them are computed are generally the same rates assumed in calculating the policy reserves and premiums. To substitute for the reserve deduction, a deduction for interest paid on indebtedness in the amount of the guaranteed interest included in these payments would give the stock companies a decided advantage over the mutual companies at the expense of the policyholders of the latter which was just what Congress intended to prevent when it continued the reserve deduction at a fixed statutory rate in the Revenue Act of 1932."

Conclusion.

It is respectfully submitted that this is a case which this Court ought to review. It involves important questions of federal tax law. The decision below is in direct conflict with the decisions of this Court, in that it upholds the validity of a retroactive amendment of the Regulations which upsets twenty years of administrative regulations and practice by which the corresponding provision of every Revenue Act from 1913 to 1932 has been so construed and applied that life insurance companies could and did obtain deductions for this reserve. It is in direct conflict with *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267, at p. 270, where this Court held that:

"Congress intended to permit the deduction of reserves based on those policies that make a company a 'life insurance company' under the Act."

And on the alternative issues involving deductions for interest paid on indebtedness, the decision below is in conflict with the decisions of the Circuit Courts of Appeals for other Circuits which have passed on the questions.

Respectfully submitted,

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APPENDIX

TREASURY REGULATIONS

(As in force prior to December 18, 1935.)

Under the Revenue Act of 1913 (38 Stat. 172, 174), Article 147(d) of Regulations 33 provided:

"(d) The reserve funds of insurance companies to be considered in computing the deductible net addition to reserve funds are held to include only the reinsurance reserve and *the reserve for supplementary contracts* in the case of life insurance companies, the unearned premium reserves in the case of fire, marine, accident, liability and other insurance companies, and only such other reserves as are specifically required by statutes of a State within which the Company making the return is doing business * * *." (Italics supplied.)

Under the Revenue Acts of 1916 (39 Stat. 768), and 1917 (40 Stat. 302), Article 240 of Regulations 33 (Revised) contained substantially the same wording as that quoted above from Regulations 33.

Under the Revenue Act of 1918 (40 Stat. 1079), Article 569 of Regulations 45 and 45 (1920 ed.), provided:

"In the case of life insurance companies the net addition to the 'reinsurance reserve' and the '*reserve for supplementary contracts not involving life contingencies*,' and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible." (Italics supplied.)

Under the Revenue Acts of 1921 (42 Stat. 261), 1924 (43 Stat. 289) and 1926 (44 Stat. 2nd Pt. 47), Article 681 of Regulations 62, 65 and 69 provided:

"Generally speaking, the following will be considered reserves as contemplated by the law: Items

7, 8, 9, 10 and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business."

Under the Revenue Acts of 1928 (45 Stat. 843) and 1932 (47 Stat. 224), Article 971 of Regulations 74 and 77 provided:

"Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies, and items 16-19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business."

From the liability page of the annual statements for life insurance companies, referred to in these Regulations, it will be noted that for the years 1913 to 1925 inclusive, Item 9, and for the years 1926 to 1934 inclusive, Item 10, read:

"Present value of amounts not yet due on supplementary contracts *not* involving life contingencies."

See: *Bulletin "H," Income Tax Rulings Peculiar to Insurance Companies*, issued by the Treasury Department on April 9, 1921, at pages 7 and 27, where the liability page of the annual statements for life insurance companies is set out.

And see: *Pan-American Life Insurance Co. v. Commissioner* (1938) 38 B. T. A. 1430, at page 1437 and notes, *aff'd* (CCA-5, 1940), 111 F. (2d) 366, *aff'd* (1940) 311 U. S. 273.

TREASURY REGULATIONS DEFINING "ANNUITIES"

Article 22(b)(2)-2 of Regulations 86, 94 and 101; and Section 19.22(b)(2)-2 of Regulations 103; define the term "Annuities" as follows:

"*Annuities*—Amounts received as an annuity under an annuity or an endowment contract include amounts received in periodical installments, whether annually, semiannually, quarterly, monthly, or otherwise, and *whether for a fixed period, such as a term of years, or for an indefinite period, such as life, or for life, and a guaranteed fixed period, and which installments are payable or may be payable over a period longer than one year.*" (Italics supplied.)

IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

No. 492

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

VS.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

BRIEF FOR THE PETITIONER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT

JOHN L. GRANT,
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III.—There was a valid acceptance in 1933, on the part of many beneficiaries of supplementary contracts issued in prior years, of the petitioner's offer, made at the beginning of that year, to pay <i>interest</i> at a <i>specified</i> excess rate for its retention and use during that year of funds held under their respective contracts; and legally binding contractual obligations to pay this <i>interest</i> at that <i>specified excess rate</i> resulted	26
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IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

No. 492

GUY T. HELVERING, Commissioner of
Internal Revenue,

Respondent.

*On Writ of Certiorari to the United States Circuit
Court of Appeals for the Second Circuit.*

BRIEF FOR THE PETITIONER

Opinions Below.

The opinion of the Circuit Court of Appeals below (R. 128) is reported in 137 F. (2d) 623.

The opinion below (R. 63, 88) of the United States Board of Tax Appeals (now the Tax Court of the United States) is reported in 44 B. T. A. 293.

Jurisdiction.

This proceeding, involving the petitioner's income taxes for 1933, originated in the United States Board of Tax Appeals (now the Tax Court of the United States) which entered its final order of redetermination and decision on July 17, 1941 (R. 93). The judgment of the United States Circuit Court of Appeals affirming that order and decision,

on the issue here presented, was entered August 18, 1943 (R. 134). A petition for a writ of *certiorari* was filed with this Court on November 17, 1943 and allowed by an order entered December 20, 1943 (R. 135).

The jurisdiction of this Court is invoked under Section 1141 of the Internal Revenue Code (53 Stat. 164), and Section 240 of the Judicial Code, as amended (43 Stat. 938).

Question Presented.

Is the petitioner entitled to a deduction under Section 203 (a) (8) of the Revenue Act of 1932 in the amount of the "excess interest dividends" paid within the taxable year, pursuant to the provisions of its supplementary contracts not involving life contingencies?

Statute Involved.

The statute involved is the Revenue Act of 1932 which provides in part as follows (47 Stat. 223, 224 and 225):

"Sec. 203. Net Income of Life Insurance Companies.

(a) General Rule.—In the case of a life insurance company the term 'net income' means the gross income less—

• • • • • • • •

(8) Interest.—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title."

Statement of the Case.

The petitioner is a mutual life insurance company organized and existing under and by virtue of the laws of

the State of New York, having its principal office and place of business in the City of New York and being engaged in the business of issuing and selling life insurance and annuity contracts. At all times more than 50% of its total reserve funds have been held for fulfillment of its life insurance and annuity contracts (R. 105).

During and prior to the calendar year 1933 the petitioner issued life insurance policies which gave to the insured, and in some cases to the beneficiary, the right to require the petitioner to hold the face amount of the policy after the date upon which it would otherwise be payable, supplement this amount with annual increments of interest, and pay out the increased amount in installments or otherwise over varying periods of time (R. 109, 118A). The contracts which evidence the exercise of such options under these provisions are known as "Supplementary Contracts." It has been stipulated (R. 109) and found (R. 69) that the "supplementary contracts" involved herein, consist of "options exercised under provisions 1, 2 or 4 of Stipulation Exhibit D"; and the provisions of these "optional modes of settlement in lieu of the lump sum" payment otherwise provided for in the policy, are set out in "Stipulation Exhibit D" which appears as page 118A of the Record herein (R. 69, 109).

The funds held by the petitioner under the elected optional modes of settlement here involved, which are referred to herein as supplementary contracts, totalled \$34,806,201.00 at the beginning of 1933 and \$42,326,682.00 at the end thereof (R. 69, 109). Less than \$15,000 of these amounts represented accrued but unpaid interest (R. 71, 111), the balance consisting of the unpaid principal of the face amounts of matured policies from which these supplementary contracts were derived (R. 69, 70, 109, 120).

The supplementary contracts provided for interest at the guaranteed rate of 3% per annum and for "excess interest dividends" as follows (R. 74, 118A):

"Excess Interest Dividend: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of instalment under Option 2, the amount of income during the fixed period of five, ten or twenty years under Option 3 and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society."

It has been stipulated (R. 110) and found (R. 70) that:

"The obligations arising under these option contracts were absolute obligations of the petitioner and were not in any sense contingent upon the happening of future events."

It has been stipulated (R. 122) and found (R. 73) that:

"The excess interest dividends paid by the petitioner on its Supplementary Contracts Not Involving Life Contingencies, accrued and were paid as follows under the different options set out in Stipulation Exhibit D, exercised as indicated:

Option 1 exercised by insured	.....	\$147,201.05
" 2 " " "	.....	82,158.73
" 4 " " "	.....	27,386.24
" 1 " " beneficiary	..	229,930.32
" 2 " " "	.....	36,158.40
" 4 " " "	.....	12,052.80

Total \$534,887.54"

The excess interest dividends so paid by the petitioner, for which the petitioner claims the deduction here at issue, "accrued during the year * * * at the rate declared for the year by its Board of Directors" (R. 72, 113). The specific rate at which these excess interest dividends would

accrue and be paid by the petitioner during 1933 was declared "by resolution of its Board of Directors" at "the beginning of" that year (R. 72, 112).

The petitioner contends that it is entitled to a deduction under Section 203 (a) (8) for interest paid on indebtedness in the amount of these "excess interest dividends" as well as to the deductions allowed by the court below for amounts so paid as "guaranteed interest."

On brief before the Board, the Commissioner conceded that the petitioner is entitled to a deduction claimed under Section 203 (a) (8), in the amount of guaranteed interest paid on contracts arising from the exercise of Option 1 by either the insured or the beneficiary (R. 81, 82). This is the option under which the face amount of a policy is "left on deposit with the Society at interest" (R. 74, 118A).

The court below affirmed the decision of the Board in allowing the deduction so conceded by the Commissioner; and in allowing a deduction claimed in the amount of guaranteed interest paid on contracts arising from the beneficiary's election of Options 2 and 4. The court held it error on the part of the Board to disallow a deduction claimed in the amount of guaranteed interest paid on contracts which arose from the insured's election of Options 2 and 4.

The court affirmed the decision of the Board in disallowing the deduction now at issue before this Court, in the amount of the excess interest dividends paid by the petitioner on these contracts in 1933.

This Court granted the petitioner's petition for a writ of *certiorari* to review the decision below in so far as it disallowed the deduction claimed in the amount of the excess interest dividends paid within the year (R. 135).

The respondent has sought no review of the decision below.

Specification of Errors To Be Urged.

1. The Circuit Court of Appeals for the Second Circuit erred in holding that the excess interest dividends which the petitioner determined and paid during the year 1933 on the supplementary contracts hereto involved do not constitute "interest paid * * * within the taxable year on its indebtedness" for which a deduction is provided by Section 203 (a) (8) of the Revenue Act of 1932 (47 Stat. 225).
2. The said court erred in failing to hold upon the facts as found by the United States Board of Tax Appeals (now the Tax Court of the United States) that the petitioner is entitled in full to the deductions claimed under Section 203 (a) (8) of the Revenue Act of 1932 (47 Stat. 225).

ARGUMENT

The petitioner is entitled to the deduction expressly provided by Section 203 (a) (8) of the Revenue Act of 1932 for "all interest paid * * * within the taxable year on its indebtedness" and this includes the excess interest dividends which the petitioner paid in 1933 on the supplementary contracts involved herein.

The Circuit Court of Appeals, in its opinion below (R. 132 and 133), called attention to the conflicting decisions of the Circuit Courts of Appeals for other circuits on the issue here involved.¹ The court, after noting that some of these decisions, and a subsequent Tax Court decision, had allowed the deduction for excess interest dividends,² then said (R. 133):

¹ *Lederer v. Penn Mutual Life Insurance Co.* (C. C. A.-3, 1919), 258 Fed. 81 at page 92, affirmed on other issues (1920), 252 U. S. 523; *Commissioner v. Lafayette Life Insurance Co.* (C. C. A.-7, 1933), 67 F. (2d) 209.

Penn Mutual Life Insurance Co. v. Commissioner (C. C. A.-3, 1937), 92 F. (2d) 962, at page 970.

² *Lederer v. Penn Mutual Life Insurance Co.*, *supra*; *Commissioner v. Lafayette Life Insurance Co.*, *supra*; *Jefferson Standard Life Insurance Co.* 44 B. T. A. 314.

"But it seems to us that a payment which may be made or withheld at the will of the directors of the company cannot be regarded as a payment of interest within the strict construction we are bound to adopt in construing an exemption statute."

It appears, therefore, that on the issue now before this Court, the decision below was based upon the lower court's assumption that there was no binding obligation upon the petitioner to pay these excess interest dividends as they accrued in 1933, but that such payments remained within the will of the directors up to the time each such payment was made.

This assumption is directly contrary to the facts as stipulated by the parties (R. 112, 113, 118A) and as found by the Tax Court (R. 67, 72, 73, 74).

The facts so stipulated and found, and discussed under the subsequent headings in this brief, show that:

1. The petitioner held the proceeds of policies under written agreements to pay interest thereon at a minimum rate of 3% every year, which expressly provided that "if in any year the Society declares that funds held under such options shall receive interest in excess of 3% per annum, the interest . . . shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society" (R. 109, 118A, italics supplied).
2. The specific rate at which such excess interest dividends would be paid by the petitioner for its retention and use of these funds in 1933 was determined and declared, by resolution of the petitioner's Board of Directors, at the beginning of that year (R. 112).
3. At the end of 1933, the petitioner held \$42,326.682.00 under supplementary contracts of the

various types here involved, whereas at the beginning of that year it had held but \$34,806,201.00 under such contracts (R. 69, 109). In other words, at least \$7,520,481.00, or 20% of the funds upon which these excess interest dividends were paid in 1933, were not left with the petitioner under these contracts *until after the petitioner, by resolution of its Board of Directors at the beginning of that year, had determined and declared the specific rate at which it would pay these so-called excess interest dividends* (R. 69, 72, 74, 109, 112, 118A).

4. More than forty-two per cent of the balance of the funds upon which these excess dividends were paid in 1933 were funds which the beneficiaries were privileged to withdraw at any time (R. 112, 118A, 121). These were funds which the *beneficiaries, not the insured, had "left on deposit with the Society at interest" after the specific rate at which these excess interest dividends would be paid for that year had been determined and declared* (R. 112, 118A, 121). See Point III, *infra*.
5. The excess interest dividends paid by the petitioner in 1933 "*accrued during the year*" (R. 113) solely upon the basis of the respective funds held during that year under the various contracts (R. 118A, 122). They did not accrue and were not paid in one sum, but were paid *as they accrued during the year*, with each monthly or other instalment, as such instalments became due (R. 74, 118A).
6. The petitioner's promise to pay these excess interest dividends, for its retention and use of these funds in 1933, at the specified rate deter-

mined and declared at the beginning of that year, was not conditioned upon whether it had a surplus, nor upon the earnings or profits it might realize (R. 109, 112, 118A).

The *new* supplementary contracts, issued in 1933 under policies which matured in that year, which had been *elected in 1933* by the insured, and all of the *new* supplementary contracts which had been elected by the *beneficiaries*, arose from options *which had not been elected until after* the petitioner, *at the beginning of that year*, had declared the specific rate at which it would pay excess interest dividends in that year for its retention and use of funds during that year under supplementary contracts (R. 72, 74, 112, 118A). This is true as to *all* the new supplementary contracts which had been *elected by the beneficiaries*, since the beneficiaries had no right of election until *after* the maturity of their respective policies (R. 73, 118A).

No doubt some of the *new* supplementary contracts issued in 1933, under policies which matured in that year, arose from options elected by the insured in prior years. But at any time prior to the maturity of these policies in 1933, these elections could have been cancelled "by the Insured's written order filed with the Society" (R. 74, 118A). Such cancellations could have been made after the petitioner, *at the beginning of 1933*, had declared *the specific rate* at which it would pay excess interest dividends in that year on the proceeds of policies held during that year under supplementary contracts. All of the insured, now deceased, who had been the holders of the policies from which these *new* supplementary contracts were derived, had been alive at some time in 1933 *after the beginning of that year*. Had they not been satisfied with the specific rate at which the petitioner had then declared that it would pay excess interest dividends on funds left with it during that year under supplementary contracts, those policyholders

could have, and presumably would have, cancelled any elections they had made permitting the petitioner to retain the proceeds of their policies, after maturity, under such contracts.

Each of these new supplementary contracts issued in 1933, therefore, was based upon the mutual understanding that for the balance of that year the beneficiary of the contract would receive not only interest at the guaranteed minimum rate of 3% but also excess interest dividends at *the specific rate* which had been determined and declared *at the beginning of that year*.

Both under these new supplementary contracts and under the supplementary contracts issued in prior years, the petitioner's payment of excess interest dividends constituted, as shown under Point I, *infra*, the payment of interest on its indebtedness, or as held in *United States v. Heilbroner* (C. C. A.-2, 1938) 100 F. (2d) 379 at page 381: "Sums paid. * * * for the retention and use of the face amounts of the various policies," sums which are "fairly within the meaning of the word 'interest'" as that term is used in the revenue acts. It will also be shown under Point I, *infra*, that these excess interest dividends constituted neither a distribution of surplus nor a sharing of earnings; that the petitioner's undertaking was not conditioned upon the existence of a surplus or of a profit for the year; that the supplementary contracts contemplated and provided for the payment of these so-called excess interest dividends to beneficiaries *who were not entitled to share in the petitioner's surplus, or earnings*; that, accordingly, the Tax Court's decision in *Jefferson Standard Life Insurance Co.*, 44 B. T. A. 314, in which the respondent has acquiesced (CB 1941-2, p. 7), is correct in so far as it holds that a life insurance company is entitled to a deduction under Section 203 (a) (8) of the Revenue Act of 1932 for excess interest paid on its supplementary

contracts; and that the petitioner is, likewise, entitled to the deduction here claimed.

As shown under Point 11, *infra*, the petitioner's declaration, at the beginning of 1933, of *the specific rate* at which excess interest dividends would be paid in that year, was a part of the *offer* which, when subsequently accepted, resulted in the *new* supplementary contracts issued in 1933.

Since a beneficiary has no power to elect an option until *after* the maturity of the policy (R. 118A), all new contracts elected by the beneficiaries were elected in 1933 *after* the petitioner had made this offer. Their elections, therefore, constituted acceptances of this offer. Where these new contracts arose from options *elected in 1933* by the *insured*, such elections were likewise made after the petitioner's offer had been made *at the beginning of that year*, and constituted acceptances of that offer.

The balance of these new contracts arose from options elected by the insured in prior years. But the petitioner's declaration of the specific rate at which it would pay excess interest in 1933, was obviously designed and intended to encourage policyholders to refrain from cancelling their elections of options where such elections had already been made. By thereafter refraining from cancelling their elections, made in prior years, the insured policyholders whose policies subsequently matured in 1933, thereby accepted the petitioner's offer to pay, in the event of such maturity, excess interest dividends in 1933, at the specific rate declared for that year.

The petitioner's declaration at the beginning of 1933, that it would pay excess interest dividends in that year, at a specific rate, for its use of funds held during that year under supplementary contracts, was, therefore, the offer from which these *new* supplementary contracts arose, and *but for which* the petitioner would not have been permitted, under those contracts, to retain and use the proceeds of policies maturing in 1933. As noted above, and as shown

under Point II, *infra*, the findings of fact show that these *new* contracts accounted for at least 20% of all funds upon which the petitioner paid the excess interest dividends here involved.

In view of these facts it is difficult to conceive upon what basis the Circuit Court below described the payment of this excess interest as (R. 133):

"a payment which may be made or withheld at the will of the directors of the company."

It is equally difficult to discern a basis for that remark in respect of the excess interest paid on 42.99% of the remaining funds which were held under supplementary contracts issued in prior years. This percentage of the total funds upon which petitioner paid the excess interest dividends here involved was held under option 1, elected, not by the *insured*, but by the *beneficiaries* (R. 70, 121). These *beneficiaries*, having power to withdraw their funds at will, left the funds "on deposit with the Society at interest" *after the petitioner, at the beginning of 1933, had declared the specific rate at which it would pay excess interest for its retention and use of such funds in 1933* (Point III, *infra*).

The petitioner held the balance of the funds, upon which the excess interest dividends involved were paid, under supplementary contracts issued in years prior to 1933, under which the beneficiaries may or may not have, had the power to withdraw funds at will. But even when the beneficiaries had no powers of withdrawal under these prior contracts, the petitioner was under an equally binding legally enforceable contractual obligation to pay excess interest *at the specific rate determined and declared for 1933*. This is so because, as shown under Point IV, *infra*, the petitioner, in issuing these supplementary contracts in prior years had not only guaranteed to pay interest at the minimum rate of 3% throughout the life of the contract,

but also had made the conditional promise that, if, in any following year, it should offer to pay a higher gross rate of interest to obtain new supplementary contracts, it would likewise pay interest at that higher gross rate on these contracts issued in prior years. Under these prior contracts the petitioner had expressly promised that "if in any year the Society declares that funds held under such options shall receive interest in excess of 3% per annum, the interest . . . shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society" (R. 74, 118A).

Under Point V, *infra*, it will be shown that the Circuit Court below erred in assuming that the 1942 Act, in more clearly providing for this deduction, effected a change in the law, since Congress, when first enacting the provisions for the taxation of life insurance companies, subsequently embodied in the 1932 Act, was aware of the decision in *Lederer v. Penn Mutual Life Insurance Co.* (C. C. A.-3, 1919) 258 Fed. 81 at page 92, affirmed on other issues (1920) 252 U. S. 523, expressly holding that these excess interest dividends, when paid by a mutual life insurance company, constituted a payment of interest and not a distribution of profits.

Under Point VI, *infra*, it will be shown that the respondent's own regulations require the allowance of the deduction here at issue.

I.

These excess interest dividends were sums paid by the petitioner for its use and retention of borrowed funds in 1933, and in no sense constituted a distribution of its surplus or earnings of that year or of prior years.

These excess interest dividends, for which the petitioner claims the deduction here at issue, constituted interest paid on indebtedness. As held in *United States v.*

Heilbroner (C. C. A.-2, 1938) 100 F. (2d) 379 at page 381, both the guaranteed interest and the excess interest dividends paid by mutual life insurance companies upon funds held under supplementary contracts constitute "sums paid by the companies for the retention and use of the face amounts of the various policies," and are "fairly within the meaning of the word 'interest'" as used in the revenue acts. In that case, AUGUSTUS N. HAND, Circuit Judge, speaking for the court said (100 F. [2d] 379 at p. 381):

"The items aggregating \$19,109 paid to the defendant during the year 1931 constituted the amounts due her that year both as to the guaranteed minima and as dividends apportioned to the respective policies.

"It is unimportant that no trust was created here and that the beneficiary was to receive not only 3% but any increased amounts voted as dividends. *The payments were in either event solely for the use of money ultimately payable without depletion to designated beneficiaries, and were fairly within the meaning of the word 'interest'.*" (Italics supplied.)

The so-called excess interest dividends, involved herein, were not paid in one sum but were paid, as they accrued, with each monthly or other instalment as such instalments became due (R. 74, 118A). They "accrued during the year" (R. 72, 113), and *solely upon the basis of funds held during the year* under the respective supplementary contracts (R. 74, 118A). They bore no relation to funds held by the petitioner in prior years which may have contributed to the petitioner's earnings and profits of those prior years (R. 113, 118A, 122).

On each of two supplementary contracts of the same type and for the same principal amount, held for six months during 1933, the same amount of excess interest dividends was paid for that year regardless of the fact that one contract may have been derived from a new

policy which had not been issued until after the beginning of that year, covering an insured who subsequently died in that year; and that the other was derived from a policy which had matured twenty years earlier (R. 118A, 122).

In disallowing the deduction claimed for these excess interest dividends, the Tax Court based its decision below on its prior decisions in *Penn Mutual Life Insurance Co. v. Commissioner* (two cases), 32 B. T. A. 839 and 876, aff'd on this issue (C. C. A.-3, 1937) 92 F. (2d) 962 and 972, where the Tax Court said (32 B. T. A. 839 at p. 851):

"At any rate, what was paid amounted to nothing more than voluntary distributions of earnings."

In the *Penn Mutual* cases, the Circuit Court of Appeals for the Third Circuit affirmed the Tax Court's decision disallowing a deduction for the excess interest dividends there involved, saying (92 F. [2d] 962 at p. 970):

"Section 1 of each policy is entitled '*Participation—Dividends of Surplus.*' The addition of 1.85 per cent is awarded by the trustees from surplus and only under circumstances which, in the opinion of the board of trustees, justify the addition. . . . Under the circumstances, the making of the award is in substance the declaration of a dividend." (Italics supplied.)

In affirming the Tax Court's decision on the issue now before this Court, the Circuit Court of Appeals cited, with apparent approval, the decisions of the Third Circuit in these *Penn Mutual* cases.

In the *Penn Mutual* cases, the facts there involved may have justified the decisions there reached and the statements quoted above from the opinions of the Tax Court and the Circuit Court of Appeals for the Third Circuit. The quoted excerpt from the Circuit Court's opinion in that case implies that the provisions for the excess interest

dividends, there involved, were expressly called "*Participation-Dividends of Surplus*," and states as a fact that they were "*awarded . . . from surplus*."

In the instant proceeding, however, *the facts affirmatively show* that the excess interest dividends here involved constitute neither a distribution of surplus nor a sharing of earnings.

Nothing in the petitioner's supplementary contracts, nor in the policy provisions from which they were derived, mentions *surplus* or in any way conditions the petitioner's undertaking on the existence of a surplus (R. 69, 73, 74, 109, 118A).

Nor was the petitioner required to have any surplus at all in order to contract at the beginning of 1933 to pay these excess interest dividends in that year at the specific rate then determined and declared. No such requirement is made in the statutory provision which authorized the provisions in the petitioner's policies from which these supplementary contracts arose. *Section 83(3) of the New York Insurance Law* (as in effect throughout the taxable year 1933) which provided (italics supplied):

". . . Both participating and non-participating policies may provide that in addition to the rate of interest guaranteed by the company to be paid on deferred payments of the proceeds, excess interest may be paid thereon at such rate as the company may annually declare, *and the inclusion in any non-participating policy of such provision shall not be construed to make the policy participating.* . . ."

This statute authorized the petitioner's issuance of new supplementary contracts in 1933 expressly providing for *the specific rate* of excess interest for that year which had been determined and declared at the beginning of that year, *regardless of whether the petitioner had any surplus at the beginning of 1933 or at any other time during that year.*

The petitioner's undertaking to pay excess interest dividends in 1933, as they might accrue during that year at the specific rate determined at the beginning of that year, was conditioned only upon the petitioner's retention in 1933 of funds held under these contracts (R. 70, 73, 74, 110, 118A). This undertaking was not made with reference to any surplus or earnings of prior years held at the beginning of that year, nor was it conditioned upon the continued existence of any surplus.

These facts negative the idea that the petitioner's payment of excess interest dividends on its supplementary contracts constituted a distribution of surplus or of earnings of prior years. Furthermore, these excess interest dividends, as provided in the supplementary contracts, accrued to the credit of and were paid to *beneficiaries* who *were not entitled to share in the petitioner's surplus*. See: *Mayer v. Attorney General*, 32 N. J. Eq. 815, discussed below.

Nor did these excess interest dividends, so-called, constitute a distribution of earnings for the current year. The only "earnings" mentioned in these provisions for optional modes of settlement are the earnings which the beneficiaries of the contracts will enjoy at the guaranteed minimum return at 3%, i. e. the "interest earning of 3% per annum" (R. 74, 118A). Quite obviously this is not the rate the petitioner expected to realize from the investment of these funds, for "3% per annum" was the guaranteed minimum return to the beneficiaries, and nothing in these agreements could justify the conclusion that the petitioner was undertaking to pass on to them the full earnings, either net or gross, which it expected to realize from its retention and use of the funds involved.

That these so-called excess interest dividends did not constitute a sharing of the earnings of the current year is apparent because the specific rate at which they were to be

paid was determined and declared *at the beginning of the year* and was not conditioned upon the petitioner's profits or earnings for the year (R. 112, 118A). The petitioner's undertaking to pay this excess interest for 1933, at the specific rate determined and declared at the beginning of that year, was a promise to pay this interest at that rate regardless of whether the petitioner's general business for the year, or its retention and use of the particular funds involved, might result in a profit or a loss.

As stipulated by the parties (R. 110) and as found by the Tax Court (R. 70):

"The obligations arising under these option contracts were absolute obligations of the petitioner and were not in any sense contingent upon the happening of future events."

Being neither a distribution of the profits or surplus of prior years, nor a distribution of the earnings of the current year, it would seem to follow, necessarily, that the petitioner's payment of the excess interest dividends, for which it claims the deduction here at issue, constituted a payment of interest on indebtedness.

This is consonant with the decision below (R. 132) holding that the petitioner is entitled to a deduction for the so-called guaranteed interest paid on the total funds held under these contracts. This decision necessarily includes a holding that the petitioner's liability in respect of these funds constitutes "indebtedness" within the meaning of Section 203 (a) (8) of the Revenue Act of 1932. The only *guarantee* involved in this so-called "guaranteed interest" was that the minimum rate at which interest would be paid throughout the life of the contract would be 3% (R. 118A). The so-called excess interest dividends, being merely a device to vary this rate for those years in which these funds "shall receive interest in excess of 3% per annum" (R. 118A), were obviously paid for the same

purpose as the guaranteed interest and upon the same indebtedness.

That these so-called excess interest dividends constitute *interest paid on indebtedness* and not a distribution of profits is consonant with the statutory provision authorizing the petitioner's issuance of the policies from which these supplementary contracts were derived: *Section 83 (3) of the New York Insurance Law* (as in effect throughout the taxable year involved) which expressly provided that:

“• • • the inclusion in any non-participating policy of such provision shall not be construed to make the policy participating. • • •”

The excess interest dividends accrued to the credit of and were paid to *beneficiaries* not *policyholders*. That the payment of the so-called excess interest dividends, therefore, did not constitute a distribution of profits, is indicated by the distinction between *policyholders* and *beneficiaries* which this Court pointed out in *Duffy v. Mutual Benefit Life Insurance Co.* (1926) 272 U. S. 613 at page 618; and by the decision in *Mayer v. Attorney General*, 32 N. J. Eq. 815 at pages 820 and 821, which turned on this distinction. In the *Mayer* case, cited and quoted with approval by this court in the *Duffy* case, the court pointed out that *policyholders* may (32 N. J. Eq. 815, at p. 820):

“• • • be deemed and taken as members of said corporation. As such members they managed the business through their agents, • • •”

In holding that upon the insolvency of a mutual life insurance company, the *beneficiaries* were entitled to a preference over *policyholders*, because, on maturity of each policy, the company's obligation thereunder, to the *beneficiary*, became a debt, the court said (32 N. J. Eq. 815 at p. 821):

“By such a change it became a *debt owing by the company to a third party*, not bound to make further payments of premiums, and *not entitled to act in the management of the business*. The amount of

such debt was not subject, in the legitimate conduct of the business, to its risks." (Italics supplied.)

The beneficiaries to whom this petitioner paid the so-called excess interest dividends, involved in this proceeding, therefore, were not entitled to share in the petitioner's profits since the petitioner's obligation under each of their respective supplementary contracts was "a debt owing by the company to a third party" whose funds, held by the petitioner under that contract, were "not subject, in the legitimate conduct of the business, to its risks." *Mayer v. Attorney General*, 32 N. J. Eq. 815; cited with approval by this Court in the *Duffy* case, 272 U. S. 613 at page 618, *supra*.

As held in *Lederer v. Penn Mutual Life Assurance Co.* (C. C. A.-3, 1919) 258 Fed. 81 at page 92, affirmed on other issues (1920) 252 U. S. 523, the excess interest paid by a mutual life insurance company on its supplementary contracts, there called "Trust Certificates," does not constitute a dividend either in an insurance or a commercial sense and was therefore deductible under Section II G (b) of the 1913 Act (38 Stat. 172, 173) which expressly prohibited the deduction of dividends.³

In view of the foregoing, it is respectfully submitted that the Tax Court's decision in *Jefferson Standard Life*

³ The undisputed testimony in that case shows that the interest there held to be deductible was excess interest over and above any guaranteed rate. See page 57 of the Transcript of the Record in *Penn Mutual Life Insurance Co. v. Lederer* (October Term, 1919, No. 499) 252 U. S. 523, where it appears that Frederick H. Garrigues, Mathematician of the Penn Mutual Life Insurance Co. testified as follows with reference to this interest:

"The Board, realizing that that fund was invested among the Company's assets, thought that the beneficiaries should have their fair share of such interest, and it was awarded to them, * * *"

In the *Penn Mutual's* "Trust Certificates" the guaranteed interest is included in and is a part of the face amount of each instalment. See the description of these same "Trust Certificates" in the Board's findings of fact in *Penn Mutual Life Insurance Co.*, 32 B. T. A. 839, affirmed in part and reversed in part (C. C. A.-3, 1937) 92 F. (2d) 962.

It should be noted that in this later case involving the *Penn Mutual* the earlier decision in the *Lederer* case allowing the deduction of the excess interest paid on these same Trust Certificates by this same mutual life insurance company was not called to the attention of the Circuit Court of Appeals.

Insurance Co. v. Commissioner (1941) 44 B. T. A. 314, in which the respondent has acquiesced (C. B. 1941-2, p. 7), is correct in so far as it holds that a *stock* life insurance company is entitled under Section 203 (a) (8) of the Revenue Act of 1932 to a deduction for interest paid on indebtedness in the amount of the excess interest paid by the company in 1933 on funds held under its supplementary contracts.

As shown above, excess interest so paid constitutes a distribution neither of surplus nor of earnings, but is the consideration paid by the life insurance company for its retention and use of the funds held. This is true whether the life insurance company be a *stock* or a *mutual* company. As the Circuit Court itself points out, in its opinion below (R. 133), Congress did not intend to distinguish between *stock* and *mutual* life insurance companies in the allowance of this deduction. That in the taxation of life insurance companies Congress did not intend to differentiate between *stock* and *mutual* life insurance companies, has been noted by this Court: *Penn Mutual Life Insurance Company v. Lederer* (1920) 252 U. S. 523 at page 535.

The meaning of Section 203 (a) (8) of the 1932 Act is not doubtful. It expressly provides a deduction for the petitioner in the amount of:

“All interest paid or accrued within the taxable year on its indebtedness * * *

The Circuit Court, in this proceeding (R. 132), has held that the petitioner's liability under its supplementary contracts constitutes “indebtedness” within the meaning of this provision; and in *United States v. Heilbronner* (C. C. A.-2, 1938) 100 F. (2d) 379 at page 381, *supra*, has held that the excess interest dividends paid on such contracts, by mutual life insurance companies, constitute “sums paid by the companies for the retention and use of the face amounts of the various policies * * * pay-

ments . . . solely for the use of money" which are "fairly within the meaning of the word 'interest.' "

The facts in this case, as stipulated by the parties and found by the Tax Court, which have been discussed above, clearly affirm that the excess interest dividends paid by the petitioner in 1933 for its retention and use of funds held under supplementary contracts, are likewise "payments . . . solely for the use of money" and are "fairly within the meaning of the word 'interest' " as that term is used in Section 203 (a) (8) of the Revenue Act of 1932.

It is respectfully submitted, therefore, that the Circuit Court erred in failing to allow the deduction claimed.

II.

The petitioner made an offer to pay *interest* at a *specified excess rate* for its retention and use of funds held under supplementary contracts in 1933, and as to funds held under all new supplementary contracts issued in 1933, the petitioner's offer was accepted, *thereafter*, either by the respective policyholders or by their beneficiaries, and resulted in a legally binding contractual obligation on the part of the petitioner to pay this *interest* at the *excess rate specified* for its retention and use of such funds in that year.

The issuance of supplementary contracts constitutes an important part of the business of life insurance. *Spectator Compendium of Official Life Insurance Reports*, 1941, page 136A. At the beginning of 1933, the petitioner knew that during the next twelve months approximately 15,000 of its policies would mature by the death of the insured and approximately 4000 more would mature as endowments. *Insurance Year Book 1934, Life Insurance* (The Spectator Co.) page 331. Presumably the petitioner desired to retain the proceeds of those policies under supplementary contracts. See: William K. Miller, *Supplementary Con-*

tracts, Life Officers Management Association (1935), V. 1, page 160 at page 161.

It is the custom of all life insurance companies to determine and declare *at the beginning of each year* the gross rates (i. e. *guaranteed minima* plus *specific* rates in excess of those *minima*) at which they, respectively, will pay interest for that year's retention and use of funds held under supplementary contracts.*

In accordance with this custom, the petitioner, *at the beginning of 1933*, determined and declared *the specific rate* at which it would pay excess interest for its retention and use in that year of funds held under supplementary contracts (R. 112). This action on the part of the petitioner was obviously intended and designed to encourage policyholders and policy beneficiaries to exercise options permitting the petitioner to retain the proceeds of policies which might mature in that year, and to refrain from cancelling the elections of such options where such elections had already been made.

The petitioner's determination and declaration at the beginning of 1933 of the specific rate at which it would pay excess interest for its retention and use of such funds in that year was obviously an offer to pay excess interest at that specific rate for the privilege of retaining such funds during that year. This offer was intended to constitute and did constitute the basis of the new supplementary contracts which came into being that year (R. 112, 113, 118A, 122).

Since the petitioner's determination of this specific rate of excess-interest for 1933 was made at the very beginning of that year (R. 112), it follows that all new supplementary contracts issued that year were issued with the mutual understanding that, regardless of what might happen in

* e. g. See: *Best's Insurance News, Life Edition*, Vol. 44, No. 9, pages 38 and 39, where the gross rates at which practically all life insurance companies will pay interest, respectively, for their retention and use of such funds in 1944 were published in January, 1944.

subsequent years, the petitioner would pay excess-interest *at the specific rate determined for 1933* for its retention and use during that year of the proceeds of the policies from which these contracts were derived.

In determining that rate at the beginning of the year the petitioner had made an offer. By thereafter electing options for deferred payment of the proceeds of their policies or by refraining from cancelling such elections already made, the insured or their beneficiaries, as the case may be, accepted this offer. By the resulting supplementary contracts the petitioner was legally obligated to pay excess interest at the *specified* rate for its retention and use in 1933 of the proceeds of the policies from which these new supplementary contracts were derived.

The findings of facts do not show what portion of the funds, held by the petitioner at the end of the year, represented new contracts which had been issued during the year; but they do show that, at the end of the year, the funds held by the petitioner, under all the supplementary contracts here involved, were \$7,520,481.00 in excess of the amount of such funds held at the beginning of the year (R. 69, 109).

Unstipulated, but, presumably, large amounts of the funds held at the beginning of the year were paid out *during the year* under the various instalment options. If such amounts were exactly equal to the funds held at the end of the year, under new supplementary contracts which had been issued during the year, the petitioner would have held exactly the same amount, at the end of the year, as it had held at the beginning of the year, under the supplementary contracts here involved. But at the end of 1933 the petitioner held \$42,326,682.00 under supplementary contracts of all types here involved, whereas at the beginning of that year it had held but \$34,806,201.00 under such contracts (R. 109). The *findings of fact* thus show that as a result of *new* supplementary contracts which had been

issued during the year, the petitioner, at the end of the year, held \$7,520,481.00 in excess of all the principal which had been paid out during the year, under contracts which had been issued in prior years. As a matter of fact, of the funds involved herein, the petitioner held \$15,044,700 or 40%, of the total, under new supplementary contracts issued in the year 1933. See: *Insurance Year Book 1934, Life Insurance* (The Spectator Co.) page 330.

The findings of fact do not show the total funds held under new contracts, but, as noted above, they do show that more than 20% of all funds held by the petitioner in 1933 under the supplementary contracts here involved were held under new contracts which had been issued in that year and which had been entered into with the mutual understanding that excess interest at the specific rate determined for 1933 would be paid by the petitioner for its retention and use in 1933 of the proceeds of the policies from which these contracts were derived.

As to these new contracts, petitioner's payment of excess interest dividends in 1933, at the specific rate determined for that year, was clearly the performance of a legally binding contractual obligation to pay interest at this specified excess rate.

Furthermore, it is reasonable to assume, and for the purposes of this case it should be assumed, that but for the petitioner's declaration at the beginning of that year, that it would pay this interest at the excess rate then specified, these new supplementary contracts would not have been entered into.

III.

There was a valid acceptance in 1933 on the part of many beneficiaries of supplementary contracts issued in prior years, of the petitioner's offer, made at the beginning of that year, to pay interest at a specified excess rate for its retention and use during that year of funds held under their respective contracts; and legally binding contractual obligations to pay this interest at that specified excess rate resulted.

Where an installment type option had been elected by the insured, the beneficiary had no right to terminate the contract and receive the principal amount thereof, unless the insured had so provided (R. 118A).

The stipulated facts do not indicate what proportion of the funds held under options exercised by the insured, could have been withdrawn by the beneficiaries on demand pursuant to provisions therefor made by the insured. Presumably some portion of those funds could have been so withdrawn. The provision for this right of withdrawal was so customary that in subsequent years the companies have been forced to offer higher rates of excess interest for the relinquishment of this right. *Best's Insurance News, Life Edition*, vol. 44, No. 9, January 1944.

Where instalment options had been exercised by the beneficiaries (options 2 and 4, R. 118A) the beneficiaries presumably had reserved the right to terminate the contract and withdraw the principal amount on demand, regardless of what option had been elected. Indeed, the italicized provision in these options stating that "No option of settlement elected by the Insured hereunder can be changed nor can any payment thereunder be computed except by the Insured's written order," would seem to imply that, where the beneficiaries elected the options, they would have this right of withdrawal without express reservation.

But even assuming that only in those cases where the beneficiaries had elected to leave the proceeds of the policies "on deposit with the Society at interest" (option 1, R. 118A), did they have the right to withdraw the principal amount of the contract at any time, this would mean that 42.99% of the funds held by the petitioner under supplementary contracts could have been so withdrawn (R. 70, 121).

The petitioner's offer made at the beginning of 1933 to pay excess interest at a specified rate for its retention and use of these funds during that year was unquestionably designed and intended to discourage the withdrawal of these funds. By refraining from exercising their right to withdraw these funds and by continuing to leave the funds "on deposit with the Society at interest," after the petitioner had declared the specific rate at which it would pay excess interest on these funds in 1933, these beneficiaries accepted the petitioner's offer to pay that excess interest at that specified rate for its retention and use of these funds during 1933. A legally binding contractual obligation to pay this interest at that specified excess rate resulted.

But for the petitioner's declaration at the beginning of that year, that it would pay this interest at that specified excess rate, it is reasonable to assume, and should be assumed, that the petitioner would not have been permitted to retain and use these funds during that year.

IV.

On the remaining funds, which were held under supplementary contracts issued prior to 1933 for beneficiaries who had no right to withdraw, the petitioner had always been under a *conditional*, but nevertheless legally binding, contractual obligation to pay interest in 1933 at a *specific* excess rate to be determined by subsequent events; and at the beginning of 1933 that *specific* rate was determined and the petitioner's obligation to pay this interest became absolute.

At the beginning of 1933, the petitioner was, of course, under no legally binding obligation to *offer* to pay excess interest for the year, at any specific rate, on *new* contracts which might thereafter be entered into. Nor was it under any obligation to determine and declare a specific rate at which it would pay excess interest for that year on contracts theretofore issued.

Under those prior contracts the petitioner had undertaken to pay excess interest only "if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum". The rate for any year at which excess interest, *if any*, would be paid, both on new supplementary contracts to be entered into and on old supplementary contracts already issued, was the rate which the petitioner in its *sole discretion* would determine and declare.

Nevertheless, the petitioner's undertaking to pay excess interest was not an illusory promise. It was in effect a promise to pay excess interest on these contracts in future years at the respective rates which the petitioner would offer in those years for new contracts of the same type *if the petitioner wanted to continue this branch of its business.*

Under these supplementary contracts issued in prior years, the petitioner had expressly promised that "if in

any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest . . . shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society" (R. 74, 118A). In other words, the petitioner, in issuing these supplementary contracts in prior years, had not only guaranteed to pay interest at the minimum rate of 3% throughout the life of the contract, but also had made the conditional promise that, if, in any following year, it should offer to pay a higher gross rate of interest to obtain new supplementary contracts, it would likewise pay interest at that higher gross rate on these contracts issued in prior years.

In this respect the petitioner's undertaking is analogous to that of the auto manufacturer in *Moon Motor Car Co. of New York v. Moon Motor Car Co., Inc.* (C. C. A.-2, 1928) 29 F.2d 3 at page 4, of which L. HAND, Circuit Judge, speaking for the Court said:

"The maker promised not to sell any cars within the specified district, except to the dealer, who in turn promised to buy 900 cars, to sell no other make of cars anywhere, to set up a shop, and to push the sales. These promises were given in exchange for each other and created a contract; of so much there can be no doubt.

"Suppose that the dealer has promised to buy, and the maker has not promised to sell. Nevertheless the dealer had his monopoly by virtue of which the maker must sell to him, if he would sell at all. The contract had been in force for more than three years, and had only seven months to run; we cannot say that it was an impossible task to show, with certainty enough to support a verdict, how many cars the maker would in fact have delivered under the pressure of this limitation, even though he was not legally bound to deliver any at all."

In the *Moon Motor Car Co.* case, the auto manufacturer was not legally bound to sell his dealer any cars at all. In the instant proceeding, the petitioner was not legally bound to determine and declare any excess interest for 1933 at all. But if the petitioner was to offer any excess interest for that year in order to obtain new contracts, it would have to pay the same excess interest on prior contracts; just as in the *Moon Motor Car Co.* case, if the auto manufacturer was to sell any cars at all in his dealer's territory, he would have to sell those cars to his dealer.

The policyholders and beneficiaries who had elected the options leading to those prior contracts could rely upon the petitioner being just as anxious to retain and use the proceeds of policies maturing in future years as it was to retain and use the proceeds of policies in those years in which their contracts were issued. To obtain new contracts in future years the petitioner would have to determine and declare excess interest dividends at specific rates sufficiently high to make the gross rates substantially equivalent to the going rates on money for those future years. But the petitioner could not determine and declare a rate for excess interest dividends on new contracts, for any year, without obligating itself to pay excess interest at that same rate on contracts theretofore issued. In view of "the pressure of this limitation," the policyholders and beneficiaries, in entering into these supplementary contracts in prior years, had a reasonable expectation of receiving interest at satisfactory excess rates in the years to follow, including the year 1933; and it cannot be said that the petitioner's undertaking to pay this interest, at specific excess rates to be subsequently determined, was an illusory promise. *Moon Motor Car Co. of New York v. Moon Motor Car Co., Inc.* (C. C. A.-2, 1929), *supra*.

True it was a conditional promise. But it is elementary law that a conditional promise is good consideration for a

contract, and is enforceable upon the happening of the condition. See: *Restatement of the Law of Contracts*, §§ 77, 79.

Performance of this conditional promise was at the option of the petitioner since it was within the power of the petitioner to see that the condition never happened. But the promise of either party to a contract may be optional if the exercise of the option not to perform involves a detriment to the promisor. *Moon Motor Car Co. of New York v. Moon Motor Car Co., Inc.* (C. C. A.-2, 1928) 29 F. (2d) 3, *supra*. For other cases see: *Note, A Promise Dependent on a Subjective Contingency as a Cause of Action and as a Consideration* (1926), 26 Col. L. Rev. 724. And see: *Restatement of the Law of Contracts*, § 79.

As stated in *Williston on Contracts* (1936, revised ed.) vol. 1, Sec. 104, at page 351, with reference to employment contracts:

"The promise of either party may be optional, if the exercise of the option not to employ or to serve involves a detriment to the promisor, or a benefit to the promisee."

In the supplementary contracts which petitioner had issued prior to 1933, petitioner made an apparent promise to pay excess interest for 1933 on the funds held in that year under such contracts, at the specific rate to be determined and declared by the petitioner in that year for new supplementary contracts to be issued in that year, *unless* the petitioner should decide not to issue new contracts that year. Though the petitioner could have refused to determine and declare a specific rate of excess interest for 1933, it could not then have kept its promise except by not offering to pay gross interest in excess of 3% on new contracts to be issued that year. That would have made it difficult if not impossible for the petitioner to obtain new

business in that year in supplementary contracts; and would, itself, have been a sufficient consideration had it been bargained for. See: illustration 2 under § 79 of the *Restatement of the Law of Contracts*.

When the petitioner, at the beginning of 1933 (R. 112) determined and declared the specific excess rate at which it would pay *interest* for its retention and use in that year of funds thereafter left with it under supplementary contracts, the condition, which had theretofore limited its promise to pay *interest* at an excess rate in that year on prior contracts, happened. Thereafter it was obligated under those prior contracts to pay *interest* in 1933 at the specific excess rate determined and declared for that year.

As the Court in *Moon Motor Car Co. of New York v. Moon Motor Car Co., Inc.* (C. C. A.-2, 1928), 29 F. (2d) 3 at page 4, said:

“There is no objection to a promise that it is indefinite so long as the parties can tell when it has been performed, and it is enough if, when the time arrives, there shall be in existence some standard by which that can be tested.”

Accordingly, even as to those contracts under which the beneficiaries had no right to withdrawals in 1933, the petitioner's payment of excess interest at the rate determined and declared for its use and retention of funds in that year under supplementary contracts, was in no sense a voluntary distribution, but was the performance of a legally binding contractual obligation to pay *interest*; and, presumably, *but for* the petitioner's conditional promise to pay this *interest*, these older, supplementary contracts would not have been entered into.

V.

The Circuit Court below erred in assuming that, on the issue here involved, the Revenue Act of 1942 effected any change in the law.

In its opinion below, the Circuit Court assumes (R. 133) because Congress, in the 1942 Act, has more clearly provided for the deduction of excess interest dividends paid by life insurance companies on funds held under supplementary contracts, that, in this respect, the enactment of the Revenue Act of 1942 effected a change in the law.

In this, it is respectfully submitted, the Circuit Court erred. Section 203(a) (8) of the Revenue Act of 1932 under which the deduction here involved is claimed, is a *verbatim* re-enactment of section 245 (a) (8) of the Revenue Act of 1921 (42 Stat. 261), then first enacted as part of the plan for taxing life insurance companies subsequently embodied in the 1932 Act. This provision was originally enacted in 1921 after Congress, through the Ways and Means Committee, had been informed "of the decisions of the United States courts . . . under the internal revenue acts from 1909 to 1919," including the decision in *Lederer v. Penn Mutual Life Insurance Co.* (C. C. A.-3, 1919), 258 Fed. 81, *supra*, which, the Ways and Means Committee was advised, had held that excess interest paid by a mutual life insurance company on its supplementary contracts is deductible under those acts on the ground that "interest so paid is not a dividend." *Notes on the Revenue Act of 1918* (Printed for the Use of the Committee on Ways and Means) Part I, page 3 and Part II, page 76.

Nothing in the enactment of the 1942 Act can be deemed to limit the corresponding provision of the 1932 Act in respect of the taxable year 1933. As this Court, in *Penn Mutual Life Insurance Co. v. Lederer* (1920) 252 U. S. 523, at pages 537 and 538, pointed out:

"The legislative history of an act may, where the meaning of the words used is doubtful, be resorted to as an aid to construction. * * * But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question."

Furthermore, the meaning of Section 203 (a) (8) of the 1932 Act is not doubtful. It expressly provides a deduction for the petitioner in the amount of:

"All interest paid or accrued within the taxable year on its indebtedness. * * *"

and as shown under Point I, *infra*, the petitioner's obligations under the supplementary contracts, here involved, constituted "indebtedness"; and the excess interest dividends, for which it claims the deduction here at issue, constituted "interest" paid on this indebtedness; all within the meaning of the quoted provision of Section 203 (a) (8) of the Revenue Act of 1932.

It is respectfully submitted, therefore, that the deduction claimed, is one within the clear meaning of the quoted statutory provision, and nothing in the enactment of the Revenue Act of 1942 can be deemed to change this clear meaning.

VI.

The respondent's own regulations require the allowance of the deduction claimed in the amount of the excess interest dividends paid by the petitioner on its supplementary contracts in 1933.

In construing Section 203 (a) (8) of the Revenue Act of 1932, Article 975 of Treasury Regulations 77, as added in 1935 by TD 4615, CB, XIV-2, page 310 at page 312, provides:

“(4) if a life insurance company pays interest on the proceeds of life insurance policies left with it pursuant to the provisions of supplementary contracts, not involving life contingencies, or similar contracts, the interest so paid shall be allowed as a deduction from gross income, except that such deduction shall not be allowed in respect of interest accrued in any prior taxable year to the extent that the company has had the benefit of a deduction of 4 per cent or $3\frac{3}{4}$ per cent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds.”

This regulation, like the Act itself, provides quite simply and clearly that if the petitioner pays interest on the indebtedness represented by the supplementary contracts here involved, it shall receive a deduction in the amount of the interest so paid.

Nothing in the quoted regulation attempts to bar a deduction for conditional interest so paid; and any such attempt would be invalid provided that at the time of payment the limiting condition had happened and the liability to pay the interest was absolute as in the instant proceeding. See: *Mertens on the Law of Federal Income Taxation* (1942) vol. 4, page 544, note 40, where it is stated:

“If there is a conditional primary indebtedness, payments which are alleged to represent interest are not deductible. If, however, there is a fixed obligation to pay the principal amount, payments of ‘interest’ on such amounts will be deductible even though the liability to pay such interest does not arise until a date subsequent to that on which the primary indebtedness arose.”

Conclusion.

The excess interest dividends paid by the petitioner in 1933 pursuant to its supplementary contracts, were sums paid by the petitioner for its retention and use of funds held under those contracts. These sums constituted interest paid by the petitioner within the taxable year on its indebtedness, for which a deduction is provided by Section 203 (a) (8) of the Revenue Act of 1932.

It is, therefore, respectfully submitted that the judgment of the court below, on the issue here involved, should be reversed.

Respectfully submitted,

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Dated, February 16, 1944.

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CHARLES ELMORE CRO

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 492

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

• PETITIONER'S REPLY BRIEF

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT

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393 Seventh Avenue,
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<i>Revenue Act of 1932</i> , Section 203 (a) (8), (47 Stat. 225)	1

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of
Internal Revenue,

Respondent.

No. 492

*On Writ of Certiorari to the United States Circuit
Court of Appeals for the Second Circuit.*

PETITIONER'S REPLY BRIEF

*To the Honorable the Chief Justice and the Associate
Justices of the Supreme Court of the United States:*

**The respondent has failed to overcome the facts
and authorities which show that this petitioner is
entitled to the deduction sought.**

The respondent cites (Br. 7, 8) cases in support of the
rule that an exemption provision in a tax act should be
strictly construed. But the simple issue before this Court
does not turn upon a strict or liberal construction of the
statute. The Act (Br. for the Pet., p. 2) provides that
the petitioner shall have a deduction in the amount of:

"all interest paid . . . within the taxable year on its indebtedness." The respondent points out (Br. 9) that this Court has held that the "*interest*" for which this deduction is provided means: "the amount which one has contracted to pay for the use of borrowed money." The petitioner does not seek a more liberal construction.

It is beyond question that the obligations, upon which the payments here involved were made, constitute "*indebtedness*." The parties have stipulated (R. 110, 118A) that these obligations *for the payment of money* were "*absolute obligations* . . . not in any sense contingent upon the happening of future events." Accordingly, the Circuit Court of Appeals below has held (R. 132) that the petitioner's liability *on all the funds involved* constitutes "*indebtedness*" within the meaning of the Act. The respondent does not question that decision. It is the *law of the case*.

The simple issue before this Court, therefore, is whether the so-called "excess interest dividends" paid by the petitioner constitute: "the amount which one [the petitioner] has contracted to pay for the use of borrowed money."

In contending that these payments did not constitute consideration paid for the use of borrowed money, the respondent bases his contention on *but two facts*. These *two facts* which, as hereinafter shown, do not support his contention, are:

1. The payments were called "excess interest dividends" (R. 118A); and
2. The determination of the specific rate at which "excess interest dividends" would be paid in 1933 was within the discretion of the petitioner's Board of Directors *until* that determination was made at *the beginning of that year* (R. 112).

The first of these facts has no probative value since the term "excess interest dividends" is wholly non-committal on this issue. The respondent (Br. 8) italicizes the word: "*dividends.*" The petitioner prefers to italicize the word: "*interest.*" There is no magic in the use of either term. *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) vol. 4, Sec. 26.10, and the authorities there cited. There is greater significance in the fact that the same printed provisions of the contracts, which call these payments "excess interest dividends," expressly state that these payments constitute: "*interest in excess of 3% per annum.*" (R. 74, 118A, italics supplied.)

That the payments did in fact constitute *interest* and not *dividends* is shown by the *facts* pointed out under Point I of the Brief for the Petitioner, and by the authorities there cited; *facts* and *authorities* which the respondent in his brief has not attempted to dispute.

The fact that the determination of the specific rate at which "excess interest dividends" would be paid in 1933, was wholly within the discretion of the petitioner's Board of Directors *until* that determination was made at *the beginning of that year*, is utterly lacking in significance. The amount of interest which any prospective corporate borrower *offers* to pay for the use of borrowed money is always (Br. 8) "determinable at the will of the company's directors" *prior to the making of the offer*. But when the rate of interest to be offered has been determined and is offered, and there is an acceptance of that offer, and the parties to the loan transaction thereby mutually agree upon that rate, payments made in accordance therewith constitute (Br. 9): "the amount which one has contracted to pay for the use of borrowed money."

The significant and controlling facts are those which occurred *subsequently*, as stipulated by the parties and

found by the Tax Court, which are discussed under Points I, II, III and IV of the Brief for the Petitioner. As there pointed out these subsequent facts show that, at the beginning of the taxable year, the petitioner's Board of Directors did exercise its discretion and did offer to pay *interest* at a specific excess rate for its retention and use of funds held during that year under the supplementary contracts here involved; that this offer was accepted, and resulted in legally binding contractual obligations to pay the so-called "excess interest dividends" as *interest* for the retention and use of such funds.

Only by closing his eyes to these subsequent facts can the respondent justify his repeated assertion (Br. 6, 8, 9, 11, 12 and 13) that the payment of these so-called excess interest dividends was "a payment which may be made or withheld at the will of the directors."

With reference to this repeated assertion, it would be enlightening to learn how the respondent distinguishes the interest payments made under *new* supplementary contracts issued in 1933,¹ at the *guaranteed minimum rate* of 3% from those made under these *new* contracts at the *specific excess rate* which had been determined and declared *at the beginning* of that year (R. 112).

Just as the specific *excess rate* of interest offered for 1933 was (Br. 8) "determinable at the will of the company's

¹ A large proportion of the total funds upon which these so-called "excess interest dividends" were paid, were held under *new* supplementary contracts entered into *after* the specific excess rate for 1933 had been determined and declared *at the beginning of that year*. See: Point II of the Brief for the Petitioner, where it is pointed out that the findings of fact show that *at least* \$7,520,481.00, or 20% of the total funds involved were held under such *new* contracts.

As a matter of fact, the petitioner held \$15,044,700.00, or 40% of the total funds involved herein under these *new* supplementary contracts so issued in 1933. See: *Insurance Year Book, 1934, Life Insurance* (The Spectator Co.) p. 330; and item 10, page 2, of the petitioner's *Annual Statement for 1933*, filed with the Insurance Department of the State of New York.

This Court has held that it can take judicial notice of the facts shown in this petitioner's annual statement: *Equitable Life Assurance Society v. Brown* (1909), 213 U. S. 25 at page 42, cited by the respondent (Br. 8).

directors" prior to the making of that offer, so it has always been within the power of the petitioner's Board of Directors to determine what, if any, *guaranteed minimum* rate of interest would be offered in its policy provisions for supplementary contracts. The consideration offered by the petitioner at the beginning of 1933 for its retention and use of funds under new supplementary contracts which thereafter might be entered into, was a gross rate of interest consisting of the *guaranteed minimum rate of 3%* plus the *excess rate then specified*. Each of these component rates had been determined (Br. 6, 8) "at the will of" and (Br. 8, 9, 12, 13) "within the discretion of" the petitioner's Board of Directors.

How can the respondent distinguish between: (1) the payment made at this *guaranteed minimum rate of 3%* for which the petitioner is admittedly entitled to a deduction; and (2) the payment made at the *specified excess rate* for which the respondent insists that the petitioner is not entitled to a deduction? In the case of each new supplementary contract, both of these component payments were made on the *identical fund* under the *identical contract* entered into pursuant to the *identical offer* (R. 118A). Both of these component payments were made pursuant to the terms of the *identical offer* and quite obviously for the *identical purpose*, i. e., as consideration for the petitioner's retention and use of the fund held. Both payments had been unconditionally promised as *interest*, at the respective rates *specified*, and were to be paid regardless of what surplus the petitioner then had or what profit or loss it might thereafter experience (R. 110, 118A). How can they be distinguished?

The respondent expressly refuses (Br. 8) to concede that the so-called excess interest dividends need not be paid from surplus. No facts are cited to justify this refusal nor does the respondent attempt to refute the facts

and *authorities* cited by the petitioner (Br. for the Pet., Pt. 1) which show that its promise to pay this *interest* at the excess rate *specified* was an unconditional promise made without regard to the surplus or profits which it then had or might thereafter enjoy.

The respondent does admit that (Br. 12, fn. 6)

*"the provision of the New York Insurance Law
 • • • authorizing the payment of excess interest
 does not in terms require that such excess be paid
 from surplus • • •"*

In making this admission, however, the respondent expresses a (Br. 12) "doubt that the directors of the company would or properly could declare excess interest dividends out of capital." In support of this "doubt," and by way of intimating that this excess interest must have been a distribution of surplus, he points out (Br. 12, fn. 6) that:

*"The provision of the New York Insurance Law,
 • • • authorizing the payment of excess interest
 • • • is found in a section of the law entitled 'Dis-
 tribution of Surplus to Policyholders.'"*

But this statutory provision which authorizes the petitioner's undertaking to pay the "*excess interest*" here involved, appears in the third paragraph of this Section 83, which *expressly* deals with this and other subjects, as *matters not concerned with a distribution of surplus*. The entire section is set out in an appendix hereto.

In citing cases and texts which deal with the distribution of *surplus to policyholders* (Br. 8, 12), the respondent is apparently confused as to the *facts* in this proceeding. The issue before this Court has nothing to do with distribution of *surplus to policyholders*. The following cases and portions of texts cited by the respondent (Br. 8, 8fn. 2,

12fn. 6) deal solely with distributions to *policyholders* of amounts which are admittedly *surplus*:

Greeff v. Equitable Life Assurance Society (1899), 160 N. Y. 19, 32;

Equitable Life Assurance Society v. Brown (1909), 213 U. S. 25, 47;

Berryman v. Bankers' Life Insurance Co. (1907), 117 App. Div. 730;

Penn Mutual Life Insurance Co. v. Lederer (1920), 252 U. S. 523;

W. F. Gephart, *Principles of Insurance: Life* (1917) pages.257-258;

S. S. Huebner, *Life Insurance* (1921) page 252.

Nothing held or said in any of these cases or in the portions of the texts cited has anything to do with money owed by a life insurance company to the *beneficiaries* of its matured policies, or to any other *creditor*, or with payments made to *beneficiaries* or other *creditors* whether such payments be termed "interest" or "dividends."

With reference to the above citations, see Point I of the Brief for the Petitioner where the *facts* and *authorities* are fully discussed; where the essential difference between *dividends paid to policyholders* and the so-called "*excess interest dividends*" here involved is pointed out; and where it is shown that these so-called "*excess interest dividends*" were payments made to *beneficiaries* as *interest* on the debts owed to them by this petitioner.

The respondent cites (Br. 9) cases in which corporate taxpayers have been denied deductions for *dividends* paid on the *stock* of the respective corporations, which the taxpayers had attempted to deduct as "interest paid on indebtedness." But those cases were decided upon the absence of a debtor-creditor relationship between the respective corporations and their stockholders and, there-

fore, cannot support the respondent's contentions here where the debtor-creditor relationship between the petitioner and the beneficiaries *as to all the funds involved* is beyond question. Furthermore, the reasoning of the opinions in these cases which the respondent cites shows that this petitioner is entitled to the deduction here at issue. See especially: *John Wanamaker Philadelphia v. Commissioner* (C. C. A.—3), decided December 30, 1943 (1944 C. C. H. par. 9124; 1944 P-H, par. 62323). This is so because the "excess interest dividends" here involved have *all* the characteristics which the opinions in these cases hold to be of importance in indicating that payments constitute deductible interest:

(1) The payments here involved were made upon obligations for the payment of money which had *fixed or determinable maturity dates* (R. 118A);

(2) These payments *accrued and were payable even in the absence of profit* (R. 110, 118A);

(3) They accrued at a *specified excess rate* which was *fixed* for the year (R. 112, 118A);

(4) They accrued and were payable to *beneficiaries* who had no voice in the management of the company and who, in the event of the petitioner's insolvency, were entitled to share in its assets *before* the policyholders.

Mayer v. Attorney General, 32 N. J. Eq. 815,
at page 821.

(5) The payments were made as consideration for the retention of funds which had not been invested *at the risk* of the petitioner's business.

Mayer v. Attorney General, 32 N. J. Eq. 815,
at page 821.

The respondent cites (Br. 10, fn. 5) *Missouri State Life Insurance Co. v. Commissioner* (C. C. A.—8, 1935) 78 F. (2d) 778, but that decision was concerned, not with *supplementary contracts*, but with *tontine dividend deposits* which accrued to those policyholders, *if any*, who survived the twenty year period. The court there held that this "*contingent policy liability*" was not "*indebtedness*" and therefore could not support a deduction for "interest paid on indebtedness." There is no question as to the "*indebtedness*" in the instant proceeding for *as to all the funds involved* it was held below (R. 132) that the petitioner is entitled to a deduction for interest paid on *indebtedness* in the amount paid at the guaranteed minimum rate, and the respondent does not question the correctness of that decision.

The respondent cites (Br. 10, fn. 5) *Penn Mutual Life Insurance Co. v. Commissioner* (C. C. A.—3, 1937), 92 F. (2d) 962, but that decision is to be distinguished by the facts stated by the court in its opinion in that case as pointed out on page 15 of the Brief for the Petitioner.

The respondent cites (Br. 10 fn. 3) cases in support of his regulations as "*an appropriate guide in interpreting the statute.*" But as noted under Point VI of petitioner's main brief *those regulations require the allowance of the deduction here at issue.*

The respondent cites (Br. 9) *Old Colony R. Co. v. Commissioner* (1932) 284 U. S. 552 at pages 560 and 561, but in so far as this decision is at all in point it clearly supports the position of this petitioner. This Court there said:

"The popular or received import of words furnishes the general rule for the interpretation of public laws.

.

“And as respects ‘interest’ the usual import of the term is the amount which one has contracted to pay for the use of borrowed money. *He who pays and he who receives payment of the stipulated amount conceives that the whole is interest.*” (Italics supplied.)

The amount which this petitioner “contracted to pay for the use of borrowed money” included the so-called excess interest dividends at issue here (Points I, II, III, and IV of petitioner’s main brief). These payments, at the *specific excess rates* which had been promised at the beginning of the year, plus those made at the *guaranteed minimum rate of 3%*, together constituted “*the stipulated amount*” of which “*the whole is interest.*”

That this was the popular understanding is indicated by the published *gross rates* at which life insurance companies respectively will pay interest on the proceeds of policies left with them under supplementary contracts. For the current year these gross rates for most of the leading life insurance companies are tabulated and published in *Best Insurance News, Life Insurance*, vol. 44, no. 9, January, 1944. For similar tabulations of these gross rates for various companies for 1933, see: *The Spectator*, vol. CXXX, no. II, January 12, 1933, page 25; and no. XIX, May 11, 1933, page 36. In these tabulations the gross rates, i. e., guaranteed minimum plus the specific excess rate for the year, are published under the heading: “Rate of Interest Payable in 1933 on Proceeds of Policies.” The gross rate for this petitioner is there shown as 4.65% for the year 1933. This of course includes the guaranteed minimum rate of 3% plus a specific excess rate of 1.65%.

Of this “stipulated amount . . . the *whole* is interest.” *Old Colony R. Co. v. Commissioner, supra.*

CONCLUSION.

It is, therefore, respectfully submitted that the judgment of the court below, on the issue here involved, should be reversed.

Respectfully submitted,

JOHN L. GRANT,
Counsel for Petitioner,
393 Seventh Avenue,
New York 1, N. Y.

Dated, March 7, 1944.

APPENDIX**Section 83 of the New York Insurance Law**

(As in effect throughout the year 1933)

NOTE: The paragraphs of this section were not numbered until 1934. However, since the third paragraph has been cited in the briefs of both parties as Sec. 83(3), the paragraphs are here numbered as they subsequently were in the following year.

§ 83. Distribution of surplus to policyholders. 1. Except as herein provided, every domestic life insurance corporation heretofore or hereafter organized, whether incorporated by special act or under a general statute, anything in its charter or certificate of incorporation or in such special act or general statute to the contrary notwithstanding, shall provide in every policy issued on or after the first day of January nineteen hundred and seven, that the proportion of the surplus accruing upon said policy shall be ascertained and distributed annually and not otherwise. Upon the thirty-first day of December of each year, or as soon thereafter as may be practicable, every such corporation shall well and truly ascertain the surplus earned by such corporation during said year. After setting aside from such surplus such sums as may be required for the payment of authorized dividends upon the capital stock, if any, and such sums as may properly be held for account of existing deferred dividend policies, and for a contingency reserve not in excess of the amount prescribed in this article, every such corporation shall apportion the remaining surplus equitably to all other policies entitled to share therein. Except in the case of a term or an industrial policy, the share of surplus so apportioned in the case of a policy issued on or after the first day of January, nineteen hundred and seven shall, at the option of the owner of the policy, be payable in cash, or shall be applicable to the payment of any premium or premiums upon said policy or to the purchase of a paid-up addition thereto or shall be permitted to accumulate to the credit of the policy at such rate

of interest as shall be allowed by the company, and with such interest shall be payable upon the maturity of the policy or shall be withdrawable in cash by the owner of the policy on any anniversary of the date of issue thereof. Such corporation may require the owner of the policy to elect the manner in which said dividends shall be applied as above provided by mailing a written notice of the amount of the said dividends and the options available as aforesaid in a sealed envelope in the manner required by the provisions of this chapter for notices of premium payments, and in case the owner shall fail to notify the company in writing of his election within three months after the date of the mailing of said notice, the surplus shall be applied by the company to the purchase of a paid-up addition to the sum insured.

2. In the case of a term policy issued on or after the first day of January, nineteen hundred and seven the share of surplus so apportioned shall be payable to the owner of the policy in cash or shall be applicable to the payment of any premium or premiums upon said policy, or if so provided in the policy shall be permitted to accumulate to the credit of the policy at such rate of interest as shall be allowed by the company and in such case shall be payable upon the maturity or expiration of the policy or shall be withdrawable in cash by the holder of the policy on any anniversary of the date of issue thereof. In case of industrial policies the share of surplus so apportioned shall be payable annually in such manner as may be determined by the company with approval of the superintendent of insurance. The dividends declared as aforesaid in the case of a policy issued on or after the first day of January, nineteen hundred and seven, shall be payable respectively either upon the anniversary of the policy next after said thirty-first day of December, or upon a day certain in the year following said date, according to the rules of the corporation or the terms of the policy, and upon the sole condition that the premium payments for the policy year current upon said thirty-first day of December shall have been completed, except that, as to all policies whose anniversaries shall occur after April thirtieth, nineteen hundred and twenty-one, the company may, in lieu of complying with the

foregoing provision relating to time of payment, make such dividends payable thereafter upon the anniversary of the policy next following each thirtieth day of April, and upon the condition that the premium payments for the policy year current upon such thirtieth day of April shall have been completed.

3. This section shall not apply to any stock life insurance corporation which on or after the first day of January, nineteen hundred and seven, shall transact and shall represent itself as transacting its business exclusively upon a nonmutual basis and shall after said date issue only nonparticipating policies. Both participating and nonparticipating policies may provide that in addition to the rate of interest guaranteed by the company to be paid on deferred payments of the proceeds, excess interest may be paid thereon at such rate as the company may annually declare, and the inclusion in any nonparticipating policy of such provision shall not be construed to make the policy participating. This section shall not apply to paid-up or temporary and pure endowment insurance issued or granted in exchange for lapsed or surrendered policies. A foreign life insurance corporation which shall not provide in every participating policy issued or delivered in this state on or after the first day of January, nineteen hundred and seven, that the proportion of the surplus accruing upon said policy shall be ascertained and distributed annually and not otherwise, and which shall not ascertain and distribute the surplus accruing upon said policies annually either by providing for their payment in cash or their application to the payment of premiums or to the purchase of paid-up additions or for their accumulation as above provided in the case of domestic corporations, shall not be permitted to do business within this state.

Amended by L. 1920, ch. 296; L. 1927, ch. 467.

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 492

**THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE
UNITED STATES, PETITIONER**

v.

COMMISSIONER OF INTERNAL REVENUE

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The majority (R. 63-88) and minority (R. 88-92) opinions of the United States Board of Tax Appeals are reported in 44 B. T. A. 293. The opinion of the Circuit Court of Appeals (R. 128-133) is reported in 137 F. 2d 623.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 18, 1943. (R. 133-134.) The petition for a writ of certiorari was filed Novem-

ber 17, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. During the taxable year, 1933, the taxpayer, a mutual life insurance company, maintained reserves for its supplementary contracts not involving life contingencies. Do these reserves constitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1932, which authorizes percentage deductions in respect of such funds?

2. If that question be answered in the negative, then did the court below correctly hold that the taxpayer is not entitled, under Section 203 (a) (8) of the Revenue Act of 1932, to deduct excess interest dividends paid during the year under such supplementary contracts?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 10-15.

STATEMENT

The taxpayer is a mutual life insurance company engaged in the business of issuing life insurance and annuity contracts, transacting that business in every state except Texas. More than 50 percent of its total reserve funds have been held for fulfillment of its life insurance and an-

nuity contracts. (R. 67.) During and prior to 1933, the taxable year, the taxpayer issued life insurance policies which gave to the insured, and in some cases to the beneficiary, the right to require it to apply the net sum due under the policy upon its maturity in accordance with one of the optional modes of settlement set up in stipulation Exhibit D, which may be found on page 118A of the record. The pertinent provisions of that exhibit are as follows:

1. Deposit option: Left on deposit with the Society at interest guaranteed at the rate of 3% per annum, with such Excess Interest Dividend as may be apportioned.

2. Instalment option (fixed period): Paid in a fixed number of equal annual, semi-annual, quarterly or monthly instalments as set forth in the following table.

* * * *

4. Instalment option (fixed amount): Paid in equal annual, semi-annual, quarterly or monthly instalments of such amount as may be agreed upon until the net sum due under this policy together with interest on the unpaid balances at the rate of 3% per annum, and such Excess Interest Dividends as may be apportioned, shall be exhausted, the final payment to be the balance then remaining with the Society. If the interest and Excess Interest Dividend for any year shall be in excess of the instalments payable in such year, then the total amount of the instalments for the subse-

quent year shall be increased by the amount of such excess.

Excess interest dividend: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of instalment under Option 2, the amount of income during the fixed period of five, ten or twenty years under Option 3 and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society.

Contracts arising from the exercise of such options are generally known as supplementary contracts not involving life contingencies (R. 69).

The Board of Tax Appeals sustained the Commissioner's action in disallowing deductions in respect of supplementary contract reserves and also held that the taxpayer was entitled to deduct only a portion of the amounts claimed as interest paid, namely, the guaranteed interest at the rate of three per cent paid pursuant to Option 1 and the portion of such guaranteed interest paid under Options 2 and 4, where the beneficiary elected the option after maturity of the policy (R. 80, 82-84). The court below modified the order of the Board so as to allow the deduction of guaranteed interest paid under settlement options exercised by the insured, and affirmed the order in all other respects (R. 132-133).

ARGUMENT

The court below decided correctly the two points raised by the taxpayer in its application for a writ of certiorari, and there is no occasion for further review. These points are whether the taxpayer is entitled to a reserve deduction under Section 203 (a) (2) of the Revenue Act of 1932 (Appendix, *infra*), and, as an alternative, whether the taxpayer is entitled under Section 203 (a) (8) of the same Act (Appendix, *infra*) to a deduction for excess interest paid.

1. The reserves were carried to provide for the payment of matured life insurance policies and not to meet life contingencies. The court below correctly interpreted the decisions of this Court (*Helvering v. Inter-Mountain Life Ins. Co.*, 294 U. S. 686; *Helvering v. Illinois Ins. Co.*, 299 U. S. 88; *Helvering v. Oregon Ins. Co.*, 311 U. S. 267) to hold that Congress has not given the privilege of deduction to values that have as little relation to contingencies of life insurance as those involved in the supplementary contract reserves under consideration. In the view that this Court has so held even where the earlier regulations of the Treasury Department allowed such deductions as are claimed here, the court found it unnecessary to discuss Regulations 77, promulgated under the Revenue Act of 1932, Article 971 (Appendix, *infra*). (R. 130-132.) This, we submit, was a correct treatment of the issue.

Despite this disposition by the court below, the taxpayer interjects the regulations into the case and contends (Pet. 6-9; Br. 16-23) that the decision below conflicts with *Helvering v. Reynolds Co.*, 306 U. S. 110; and *Helvering v. Oregon Ins. Co.*, *supra*. The basis of the contention is that under the regulations existing during the tax year 1933 and prior thereto (Art. 681, Treasury Regulations 62, 1921 Act; Art. 681, Treasury Regulations 65, 1924 Act; Art. 681, Treasury Regulations 69, 1926 Act; Art. 971, Treasury Regulations 74, 1928 Act; Art. 971, Treasury Regulations 77, 1932 Act) deductions were allowed in respect of reserves for supplementary contracts such as here involved; and that the 1935 amendments to the regulations (T. D. 4615, XIV-2 Cum. Bull. 310, Appendix, *infra*); expressly denying such deductions, could not operate retroactively under the ruling in the *Reynolds Co.* case. But we do not understand that case to be at variance with the rule that an invalid regulation may be disregarded (*Manhattan Co. v. Commissioner*, 297 U. S. 129; *Koshland v. Helvering*, 298 U. S. 441), and we submit that the earlier regulations purport to allow a deduction not authorized by the law as interpreted in the relevant decisions of this Court (*Helvering v. Inter-Mountain Life Ins. Co.*, *supra*; *Helvering v. Illinois Ins. Co.*, *supra*; *New York Ins. Co. v. Edwards*, 271 U. S. 109). Indeed, the change in the regulations was precipitated by

this Court's decision in the *Inter-Mountain* case (Cf. R. 131).

The instant case is distinguishable from *Helvering v. Oregon Ins. Co.*, *supra*, where this Court held the regulations could not be retroactively amended so as to deprive the company of a deduction in respect of disability reserves, allowable under the earlier regulations. In so holding this Court (p. 271) expressly distinguished its previous decisions in the *Inter-Mountain Life Ins. Co.* and *Illinois Ins. Co.* cases on the ground that they rested upon the conclusion that the investment fund features had no relation to the insurance risks, while in combined life, health and accident policies, the health and accident reserves are based upon contingencies of the commencement and continuance of disability and have a direct and inseparable relationship to the very insurance contracts which bring the issuing company under a special tax scheme. The reserves here in controversy are different in character from the reserves dealt with in the *Oregon Ins. Co.* case and the court below correctly so held (R. 131-132).

2. As to the alternative claim for a deduction in respect of excess interest dividends paid during the taxable year, the court below took the view (R. 133) that a payment which may be made or withheld at the will of the directors of the company cannot be regarded as a payment of interest within the strict construction which must

be adopted in construing an exemption statute. This seems obviously correct and is in accordance with the decision of the Third Circuit in *Penn Mut. Life Ins. Co. v. Commissioner*, 92 F. 2d 962, 970, which necessarily overruled the earlier decision of the same court in *Lederer v. Penn Mut. Life Ins. Co.*, 258 Fed. 81, affirmed on another issue, 252 U. S. 523, to the extent that they may be considered inconsistent. However, the decision below does seem to conflict with *Commissioner v. Lafayette Life Ins. Co.*, 67 F. 2d 209 (C. C. A. 7th). In view of this we would ordinarily not oppose the granting of certiorari to resolve the conflict. But the point has been disposed of for 1942 and later years by Section 162 (a) of the Revenue Act of 1942, which provides for the inclusion of excess interest dividends such as are here involved within the definition of interest paid. See S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 146-147. And although the point is open as to earlier years (R. 133), still we doubt whether it is of sufficient importance to justify consideration by this Court. The Bureau of Internal Revenue advises that a check of its records does not disclose any substantial number of pending cases involving the right of an insurance company to deduct either guaranteed interest or excess interest dividends.

CONCLUSION

The decision is correct as to the issues here involved; the petition should be denied. If, how-

ever, the Court should believe review as to the excess interest dividends warranted, certiorari on this petition should be limited to that issue.

Respectfully submitted.

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DECEMBER 1943.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General Rule.*—In the case of a life insurance company the term “net income” means the gross income less—

* * * * *

(2) *Reserve Funds.*—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of $3\frac{3}{4}$ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of $3\frac{3}{4}$ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(8) *Interest.*—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations

of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 971 [as originally adopted]. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

* * * *

(2) Four per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of $3\frac{3}{4}$ per cent shall be substituted for 4 per cent. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized

tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is $3\frac{3}{4}$ per cent of the mean of such reserve funds held at the beginning and end of the taxable year. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies, and items 16-19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered.

ART. 971 [as amended by T. D. 4615, XIV-2 Cum. Bull. 310 (1935)]. *Tax-exempt interest and reserve funds*.—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

(2) Four per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of $3\frac{3}{4}$ per cent shall be substituted for 4 per cent.

In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled

policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is $3\frac{3}{4}$ percent of the mean of such reserve funds held at the beginning and end of the taxable year.

ART. 975 [as originally adopted]. *Other deductions.*—* * *

(3) The deduction allowed by section 203 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 23 (b) (see article 141), but this deduction includes item 17 of the disbursement page of the annual statement of life insurance companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

Article 975, as amended by T. D. 4615, *supra*, is the same as the foregoing except that it also includes a new paragraph numbered (4) at the end thereof, as follows:

(4) If a life insurance company pays interest on the proceeds of life insurance policies left with it pursuant to the provisions of supplementary contracts, not involving life contingencies, or similar contracts, the interest so paid shall be allowed as a deduction from gross income, except that such deduction shall not be allowed in respect of interest accrued in any prior taxable year to the extent that the company has had the benefit of a deduction of 4 percent or $3\frac{3}{4}$ percent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds.

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 492

**THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE
UNITED STATES, PETITIONER**

v.

COMMISSIONER OF INTERNAL REVENUE

**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT**

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 63-92) is reported in 44 B. T. A. 293. The opinion of the Circuit Court of Appeals (R. 128-133) is reported in 137 F. 2d 623.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 18, 1943 (R. 133-134). The petition for a writ of certiorari was filed November 17, 1943, and was granted December 20, 1943, on a

limited basis (R. 135). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTION PRESENTED

Whether the court below was correct in sustaining the determination of the Board of Tax Appeals that "excess interest dividends" paid by a mutual life insurance company are not deductible as "interest" paid on "indebtedness" under Section 203 (a) (8) of the Revenue Act of 1932.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General Rule.*—In the case of a life insurance company the term "net income" means the gross income less—

* * * *

(8) *Interest.*—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 975 [as originally adopted]. *Other deductions.*—* * *

(3) The deduction allowed by section 203 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 23 (b) (see article 141), but this deduction includes item 17 of the disbursement page of the annual statement of life insurance companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

Article 975, as amended by T. D. 4615, XIV-2 Cum. Bull. 310 (1935), is the same as the foregoing except that it also includes a new paragraph numbered (4) at the end thereof, as follows:

(4) If a life insurance company pays interest on the proceeds of life insurance policies left with it pursuant to the provisions of supplementary contracts, not involving life contingencies, or similar contracts, the interest so paid shall be allowed as a deduction from gross income, except that such deduction shall not be allowed in respect of interest accrued in any prior taxable year to the extent that the company has had the benefit of a deduction of 4 percent or $3\frac{3}{4}$ percent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds.

STATEMENT

The taxpayer is a mutual life insurance company engaged in the business of issuing life insurance and annuity contracts, transacting that business in every state except Texas. More than 50 percent of its total reserve funds have been held for fulfillment of its life insurance and annuity contracts. (R. 67.) During and prior to 1933, the taxable year, the taxpayer issued life insurance policies which gave to the insured, and in some cases to the beneficiary, the right to require it to apply the net sum due under the policy upon its maturity in accordance with one of the optional modes of settlement set up in stipulation Exhibit D, which may be found on page 118A of the record. The pertinent provisions of that exhibit are as follows:

1. Deposit option: Left on deposit with the Society at interest guaranteed at the rate of 3% per annum, with such Excess Interest Dividend as may be apportioned.

2. Instalment option (fixed period): Paid in a fixed number of equal annual, semi-annual, quarterly or monthly instalments as set forth in the following table.

* * * * *

4. Instalment option (fixed amount): Paid in equal annual, semi-annual, quarterly or monthly instalments of such amount as may be agreed upon until the net sum due under this policy together with interest on the unpaid balances at the rate of 3% per

annum, and such Excess Interest Dividends as may be apportioned, shall be exhausted, the final payment to be the balance then remaining with the Society. If the interest and Excess Interest Dividend for any year shall be in excess of the instalments payable in such year, then the total amount of the instalments for the subsequent year shall be increased by the amount of such excess.

Excess interest dividend: The foregoing Options are based upon an interest earning of 3% per annum; but if in any year the Society declares that funds held under such Options shall receive interest in excess of 3% per annum, the interest under Option 1, the amount of instalment under Option 2, the amount of income during the fixed period of five, ten or twenty years under Option 3 and the funds held under Option 4, shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society.

Contracts arising from the exercise of such options are generally known as supplementary contracts not involving life contingencies (R. 69).

The Board of Tax Appeals held that the taxpayer was entitled to deduct only a portion of the amounts claimed as interest paid, namely, the guaranteed interest at the rate of 3 percent paid pursuant to Option 1 and the portion of such guaranteed interest paid under Options 2 and 4, where the beneficiary elected the option after maturity of the policy (R. 80, 82-84). The court be-

low modified the order of the Board so as to allow the deduction of all guaranteed interest paid under these settlement options, but affirmed the Board's order insofar as it disallowed the deduction of the excess interest dividends above 3% (R. 132-133). The taxpayer petitioned for certiorari, and this Court granted the writ limited to the question as to the deductibility of the excess interest dividend.

SUMMARY OF ARGUMENT

A payment which may be made or withheld at the will of the directors of a company cannot be regarded as a payment of interest on indebtedness within the meaning of an exemption statute, such as Section 203 (a) (8) of the Revenue Act of 1932, here involved, and the court below correctly so held.

ARGUMENT

THE EXCESS INTEREST DIVIDENDS ARE NOT DEDUCTIBLE
AS INTEREST ON INDEBTEDNESS UNDER SECTION 203
(a) (8) OF THE REVENUE ACT OF 1932

Section 203 (a) (8) of the Revenue Act of 1932 authorizes a life insurance company to deduct from its gross income "all interest paid or accrued within the taxable year on its indebtedness * * *." The taxpayer gives its policyholders or their beneficiaries the right to avail themselves of certain optional modes of settlement

¹ The Treasury regulations for the year in question (Treasury Regulation 77, Article 975, p. 3, *supra*) also referred generally to interest on indebtedness.

of principal amounts due under the policies. These options provide (1) for the payment of guaranteed interest of 3% on the principal amount, plus "such Excess Interest Dividend as may be apportioned," and (2) for the payment of the amount due in instalments. In the computation of the instalments interest is to be paid on the unpaid balances at the rate of 3%, plus "such Excess Interest Dividends as may be apportioned." (See pp. 4-5, *supra*). The policy guarantees interest of 3%; the "Excess Interest Dividend" is an additional amount as "determined and apportioned by the Society" "if in any year the Society declares that funds held under such Options shall receive interest in excess of 3%." *Ibid.*

The court below held that the guaranteed rate of 3% was "interest" within the meaning of 203 (a) (8), and no point as to that ruling is before this Court. The court, however, affirmed the decision of the Board of Tax Appeals that the excess interest dividend did not come within the exemption. The question here is whether the excess interest dividend constitutes "interest on indebtedness" within the meaning of the statute.

The Board and the court below, following *Penn Mutual Life Ins. Co. v. Commissioner*, 92 F. 2d 962, 970 (C. C. A. 3), concluded that these payments were not interest but were in the nature of dividends. This determination seems plainly correct and finds support in the rule that exemption provisions should be strictly construed. *Deputy v.*

du Pont, 308 U. S. 488, 493; *New Colonial Co. v. Helvering*, 292 U. S. 435, 440. The additional amount was denominated, not inaccurately, as an "Interest Dividend". (Italics supplied.) The amount was determinable at the will of the company's directors; there was no obligation to pay it. Cf. *Greeff v. Equitable Life Assurance Society*, 160 N. Y. 19, 32; *Equitable Life Assurance Society v. Brown*, 213 U. S. 25, 47. It thus cannot be said to be "interest on indebtedness." (Italics supplied.) Even if it need not be paid from surplus, which we do not concede, the company is not likely to pay more than it is required to except from surplus and profits. The nature of the payment is essentially the same as in the *Penn Mutual* case, where it was designated "Participation-Dividends of Surplus." As the court declared in that case (p. 970), when the payment of the additional percentage "is a matter which rests within the discretion of the board, * * * the making of the award is in substance the declaration of a dividend."²

² "The dividends are therefore that part of the overcharges which the officials of the company decide may safely be returned to the policyholders. This fund is sometimes called the profit or interest fund, but it will contribute to a better understanding of insurance if a more careful use of the word is preserved. * * * Nor should interest be confused with dividends. Interest is the sum paid by the borrower to the lender for the use of capital. It is a guaranteed return, as, in the case of bonds, mortgages, collateral loans, or personal security." W. F. Gephart, *Principles of Insurance: Life* (1917), pp. 257-258.

The applicable regulations (Treasury Regulations 77, Art. 975, *supra*) provide that the deduction allowed by Section 203 (a) (8) is the same as that allowed other corporations,* and it seems clear that corporations generally cannot deduct, as interest paid, payments of the character here involved. In *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, this Court said (pp. 560-561) that "the usual import of the term [interest] is the amount which one has contracted to pay for the use of borrowed money." It requires little discussion to demonstrate that a payment which can be made or withheld in the discretion of the directors of a company does not fall within the scope of that definition. See also *Deputy v. du Pont*, *supra*; *Fidelity Savings & Loan Ass'n v. Burnet*, 65 F. 2d 477 (App. D. C.), certiorari denied, 290 U. S. 652; *Commissioner v. Meridian & Thirteenth R. Co.*, 132 F. 2d 182 (C. C. A. 7th); *Wanamaker v. Commissioner* (C. C. A. 3d), decided December 30, 1943 (1944 C. C. H., par. 9124).

These views are in conflict with the decision of the Seventh Circuit in *Commissioner v. Lafayette*

* This provision has stood in the regulations for many years during successive reenactments of the statute. Article 685, Treasury Regulations 62, 1921 Act; Article 685, Treasury Regulations 65, 1924 Act; Article 685, Treasury Regulations 69, 1926 Act; Article 975, Treasury Regulations 74, 1928 Act; Article 975, Treasury Regulations 77, 1932 Act, *supra*; Article 203 (a) (8)-1, Treasury Regulations 86, 1934 Act; Article 203 (a) (7)-1, Treasury Regulations 94, 1936 Act; Article 203 (a) (7)-1, Treasury Regulations 101, 1938 Act; Section 19.203 (a) (7)-1, Treasury Regulations 103,

Life Ins. Co., 67 F. 2d 209,⁴ which we believe to have been incorrectly decided. That decision has been criticized by the Board of Tax Appeals and two other circuit courts of appeals in addition to the court below.⁵

It is true that Section 163 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, amends the law so as to include within the definition of "interest paid"—

All amounts in the nature of interest, whether or not guaranteed, paid within the taxable year on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve, at the time of payment, life, health, or accident contingencies.

The report of the Senate Finance Committee (S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 146-147) states that the new section is intended to include "amounts in the nature of interest," whether guaranteed or consisting of so-called excess interest

Internal Revenue Code. Hence the regulation is an appropriate guide in interpreting the statute. *Magruder v. Washington, B. & A. Realty Corp.*, 316 U. S. 69; *Taft v. Commissioner*, 304 U. S. 351; *United States v. Dakota-Montana Oil Co.*, 288 U. S. 459.

⁴The Seventh Circuit reversed the decision of the Board of Tax Appeals reported at 26 B. T. A. 946, which is in harmony with our views.

⁵See *Missouri State Life Insurance Co. v. Commissioner*, 29 B. T. A. 401, 405, affirmed as to this point, 78 F. 2d 778, 779-780 (C. C. A. 8th); *Penn Mutual Life Ins. Co. v. Commissioner*, 32 B. T. A. 839, 848-851, affirmed as to this point, 92 F. 2d 962, 969-972 (C. C. A. 3d), *supra*.

dividends. Section 29.201-5 of Treasury Regulations 111, Internal Revenue Code, applicable only to years beginning after December 31, 1941, contains a similar provision. The amendment, however, is applicable only with respect to taxable years beginning after December 31, 1941, and it clearly effects a change, rather than a mere clarification of the law. The court below so held, saying (R. 133):

It seems clear that the statute was amended in order to make the excess interest dividends deductible as interest because theretofore they had not come within a strict construction of the statute and had been held by the Third Circuit to be outside its scope.

The taxpayer contends (Br. 22-25) that some of the funds upon which these excess interest dividends were paid in 1933 were not left with it until after its board of directors had declared such dividends for that year, and argues from this that there was a contractual obligation to pay the dividends. But we do not understand that the situation in this respect is materially different from one where stock is purchased after a dividend has been declared. It may be that there is then a contractual obligation to pay the dividend, but it does not follow that the payment is one of interest and not one which the directors had power to make or withhold in the first instance. The taxpayer also says (Br. 16-17) that these excess interest dividends were not conditioned upon the existence of

surplus or earnings and must necessarily be treated as a payment of interest on indebtedness. We doubt that the directors of the company would or properly could declare excess interest dividends out of capital," but, even assuming that this were done, it is irrelevant to the present issue because whatever may be the source of the payments they were purely within the discretion of the directors. The taxpayer further contends (Br. 26) that the beneficiaries under some of the supplementary contracts could have withdrawn the funds at will and, having left them on deposit after declaration of excess interest dividends for the current year, must be considered to have accepted the taxpayer's offer to pay the amount thereof as interest. Assuming that some of the funds could have been withdrawn at will of the beneficiaries, it certainly does not follow that the excess interest dividends paid during the year must be treated as interest. A stockholder may sell his holdings if he is not satisfied with the dividend policy of the company; that does not mean that the amount which he

⁶The provision of the New York Insurance Law, both in the tax year 1933 and at present, authorizing the payment of excess interest does not in terms require that such excess be paid from surplus, but it is found in a section of the law entitled "Distribution of Surplus to Policy Holders." See Cahill's New York Consolidated Laws, 1930, Insurance Law, Section 83 (3), found in the current New York Insurance Law, Section 216 (7). See S. S. Huebner, *Life Insurance* (1921), p. 252; cf. *Berryman v. Bankers' Life Insurance Co.*, 117 App. Div. 730 (1907); *Penn Mutual Life Ins. Co. v. Lederer*, 252 U. S. 523.

actually receives as dividends in fact constitutes interest. The taxpayer also urges (Br. 28-32) that even where the beneficiaries had no right of withdrawal, there was "in effect" a contractual obligation to pay excess interest dividends at the same rate as in cases where the funds could be withdrawn at will. But even if the contracts could be so construed, which we do not concede, that is of no consequence here, for whether any amount was actually paid as excess interest dividends was wholly within the discretion of the board.

In the light of the foregoing considerations, it seems clear that the court below correctly decided the point at issue.

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted.

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MARCH 1944.

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CHARLES ELMOORE GROPLEY
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IN THE
Supreme Court of the United States

OCTOBER TERM, 1943

No. 492

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

PETITION FOR A REHEARING ON PETITIONER'S
PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

JOHN L. GRANT,
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Supreme Court of the United States

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**PETITION FOR A REHEARING ON PETITIONER'S
PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT**

*To the Honorable, the Chief Justice and the Associate
Justices of the Supreme Court of the United States:*

The petitioner in the above-entitled cause presents this, its petition for a rehearing on its petition for a writ of certiorari, and in support thereof respectfully shows:

On November 17, 1943, this petitioner filed its petition praying this Court to review the judgment entered herein by the United States Circuit Court of Appeals for the Second Circuit, on two questions, namely:

1. Is the petitioner's reserve called "Present value of amounts not yet due on supplementary contracts not involving life contingencies" a reserve fund for which a deduction is provided by Section 203(a)(2) of the Revenue Act of 1932?

2. If the petitioner is not entitled to the reserve deduction claimed, is it entitled to a deduction under Section 203(a)(8) of the Revenue Act of 1932 in the amount of the "excess interest dividends" paid within the taxable year, pursuant to the provisions of its supplementary contracts not involving life contingencies, as well as the deductions allowed below for guaranteed interest paid on such contracts?

On December 20, 1943, this Court entered the following order herein:

"The petition for writ of certiorari in this case is granted limited to the second question presented by the petition and the case is transferred to the Summary Docket."

The jurisdiction of this Court, the statute and regulations involved, the facts involved, and the reasons for allowing the writ prayed for by this petitioner, are all set out in the petition filed November 17, 1943.

By the order quoted, this Court has decided that it is of sufficient importance to warrant its consideration to determine *how* the deduction under Section 203(a)(8) for interest paid shall be computed, *assuming but not deciding* that this is the deduction intended for supplementary contracts.

The effect of the Court's action is to continue the uncertainty which has heretofore existed as to whether the *reserve* basis under Section 203(a)(2), or the *interest paid on indebtedness* basis under Section 203(a)(8), is the one enacted for computing the deduction for these supplementary contracts.

If this uncertainty is to be removed, it would seem necessary for this Court to decide which is the deduction intended by Congress for supplementary contracts. The determination of this question requires consideration of the first question presented by the petition filed Novem-

ber 17, 1943,—a question not lightly raised in view of the fourteen years of administrative regulations and practice which consistently held the proper deduction for supplementary contracts to be the reserve deduction embodied in Section 203(a)(2) of the Act. *Reg. 62, 65, and 69, Art. 681; Reg. 74 and 77; Art. 971*; (set out in Appendix to original petition).

It is reasonable to assume that Congress intended one or the other of the two deductions provided respectively by Sections 203(a)(2) and 203(a)(8) to apply to supplementary contracts. The Treasury Regulations have always so held, both as originally promulgated and in their amended form as now in effect. But as originally issued and in force from 1921 through 1935, these Regulations held the proper deduction to be that provided by Section 203(a)(2) for reserve funds; and as now amended they hold it to be that provided by Section 203(a)(8) for interest paid on indebtedness.

As to which of these Regulations is correct, the new or the old, is a question never passed upon by this Court nor, except for the decision below, by any Circuit Court of Appeals.

Petitioner is informed that this primary question has been raised in at least two cases in the Tax Court of the United States in which appeals have been filed but no hearing had; is being raised in two cases about to be instituted in the United States District Courts; and will probably be raised in at least three other cases not yet commenced;—all by different life insurance companies. In their normal course these cases will eventually reach the United States Circuit Courts of Appeals for three circuits other than the Second Circuit.

A consideration by this Court of both questions presented by the original petition filed herein will settle the issues involved by definitely determining which of the only

two possibly controlling provisions of the Act provides a deduction for supplementary contracts and how that deduction shall be computed.

But it cannot settle the matter for other litigants and may give scant justice to this petitioner to determine how a deduction for supplementary contracts may be computed under Section 203(a)(8) of the Act without first determining whether the deduction provided by that section is the one intended by Congress for supplementary contracts. Obviously this Court cannot properly determine which of the two sections of the Act was intended to provide a deduction for supplementary contracts without considering the first question presented by this petitioner's original petition.

A proper determination of the issues raised herein would seem to require the consideration of that question.

PRAYER

WHEREFORE, petitioner prays that its petition for a rehearing on its petition for a writ of certiorari may be granted; and that upon consideration, this Court may vacate its order entered herein on December 20, 1943, and enter a new order granting the petitioner's petition for a writ of certiorari in this cause on both questions presented by that petition.

Respectfully submitted,

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,
By JOHN L. GRANT,
its Attorney,
393 Seventh Avenue,
New York 1, N. Y.

CERTIFICATE OF COUNSEL

The undersigned, counsel for petitioner herein, hereby certifies that the foregoing petition for a rehearing on petitioner's petition for a writ of certiorari is presented in good faith and not for delay.

JOHN L. GRANT,
Counsel for Petitioner.

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CHARLES ELMORE CROPLEY
CLERK

IN THE
Supreme Court of the United States

October Term, 1943

No. 492

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner;

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

PETITION FOR REHEARING

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
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Supreme Court of the United States

October Term, 1943

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES,

Petitioner,

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GUY T. HELVERING, Commissioner of
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Respondent.

No. 492

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR REHEARING

*To the Honorable, the Chief Justice and the Associate
Justices of the Supreme Court of the United States:*

The judgment of this Court in the above-entitled cause, affirming the judgment below, having been entered on March 27, 1944, the above-named petitioner presents this its petition for a rehearing, and in support thereof respectfully shows:

I.

In reaching its decision this Court was patently influenced by its misunderstanding of facts stipulated and found and set out in the record. The Court overlooked material findings of fact.

As a result of questions by the Chief Justice and answers by the respondent's counsel, in the course of the oral argument before this Court, the impression was created

that the record did not show the amount of funds which were subject to withdrawal by the beneficiaries.

It is apparent from a reading of the opinion that this erroneous impression as to the facts in the record lies at the root of this Court's decision. This is clearly indicated by footnote 3 of the opinion delivered for the Court by Mr. Justice DOUGLAS wherein it is stated:

"The amount of funds in each of these three categories does not appear, though the petitioner has offered its rough estimates."

As a matter of fact the petitioner offered no "rough estimates" of the funds which the beneficiaries could have withdrawn on demand. The exact percentages stated were expressly stipulated by the parties and found by the Tax Court. The stipulation and the findings show not only the *exact percentages* of the total mean funds held respectively under each of the options elected by the *insured* and under each of the options elected by the *beneficiaries*,¹ but also the *exact amounts of the excess interest dividends paid respectively on funds in each of these categories*.

Paragraph XXXVII-A of the Stipulated Facts (R. 122) embodied in the findings as the last part of paragraph XXXVII (R. 73), states:

¹ Paragraph XXXI-B of the Stipulated Facts (R. 121) embodied in the findings as the last part of paragraph XXXI (R. 70), states:

"Of the mean of the 'Present Value of Amounts Not Yet Due on Supplementary Contracts Not Involving Life Contingencies' held by the petitioner at the beginning and end of each of the taxable years, the following percentages were the present values of amounts not yet due under the different options set out in Stipulation Exhibit D exercised as indicated:

				1933
"Option 1	exercised by	insured	.....	27.52%
" 2	"	"	.....	15.36%
" 4	"	"	.....	5.12%
" 1	"	beneficiary	.....	42.09%
" 2	"	"	.....	6.76%
" 4	"	"	.....	2.25%
"Total				100.00%

"The excess interest dividends paid by the petitioner on its Supplementary Contracts Not Involving Life Contingencies, accrued and were paid as follows under the different options set out in Stipulation Exhibit D, exercised as indicated:

					1933
"Option 1 exercised by insured	.....				\$147,201.05
" 2 " " "	.....				82,158.73
" 4 " " "	.....				27,386.24
" 1 " " beneficiary	.....				229,930.32
" 2 " " "	.....				36,158.40
" 4 " " "	.....				12,052.80
"Total					\$534,887.54"

The Tax Court expressly found that the petitioner had paid *exactly* \$229,930.32, of the excess interest dividends, for which the deduction is claimed, on funds which had been "left on deposit with the Society at interest" (R. 73, 74). There can be no question of the beneficiaries' absolute right to withdraw these funds on demand (R. 74, 118A). Nor does the respondent dispute the fact, shown by the italicized provision of the contracts (R. 74, 118A), that the beneficiaries had the right to withdraw the funds held by the petitioner under options 2 and 4 *elected by the beneficiaries*. On the funds held under these two options, so elected, the Tax Court *expressly found* that the petitioner had paid excess interest dividends in the following *respective and exact* amounts: \$36,158.40 and \$12,052.80. Thus the Tax Court expressly found the exact amounts of excess interest dividends paid on funds which were held subject to the beneficiaries' right of withdrawal and which the beneficiaries permitted the petitioner to retain *after* the petitioner's declaration *at the beginning* of 1933 of the specific excess rate at which it would pay interest for that year (R. 72, 112). It is upon *these findings of the Tax*

Court, not upon its own "rough estimates," that petitioner stresses its claim before this Court.²

From the opinion delivered herein by Mr. Justice DOUGLAS, it appears that this Court has overlooked the further fact that these so-called excess interest dividends accrued ratably as time elapsed after the beginning of the year when the specific excess rate had been declared (R. 72, 74). This is a distinct characteristic of "interest." Dividends which have been declared on corporate stock do not accrue ratably as time elapses after their declaration.

II.

As to the entire deduction claimed, the Tax Court's decision is expressly based, not upon failure of proof, but upon an erroneous conclusion that is contrary to its own findings of fact. The decision is "not in accordance with law" as to any part of the deduction at issue.

The Tax Court did not decide this issue against the petitioner because of any lack of evidence. The decision was expressly based upon the *erroneous conclusion* that (R. 83):

"The facts pertaining to this question are substantially the same as the facts involved in *Penn Mutual Life Insurance Co. v. Commissioner*, *supra*, under

² It is true that the stipulated facts do not show the proportionate amounts of excess interest dividends respectively paid under contracts entered into before and under contracts entered into after the beginning of the year 1933 when the specific rate for that year's excess interest was declared. But, the showing of those proportionate amounts is unnecessary where the options were exercised by the beneficiaries for under both the old and the new contracts arising from options so exercised, the beneficiaries at all times could have withdrawn the funds on demand. See the italicized provision of the contracts (R. 74, 118A).

As to that part of the deduction claimed for payments made under options exercised by the insured, the showing of these proportionate amounts may not be necessary to sustain the deduction upon a proper determination of the issue. See *infra*, p. 6. Even as to this part of the deduction, therefore, the decision below should not be affirmed for failure of proof, a ground not stated by the Tax Court.

the heading 'As to the "Additional Interest" Awarded to the Policies by the Board of Trustees and Paid Out During the Years 1926 and 1928.' "

This conclusion of the Tax Court is obviously erroneous.

The facts in the *Penn Mutual* case referred to by the Tax Court are those stated in *Penn Mutual Life Insurance Company v. Commissioner* (C. C. A.-3, 1937) 92 F. (2d) 962 at pages 969 and 970. As to the payments for which that company was denied a deduction, it is there expressly stated:

"The addition of 1.85 per cent. is awarded by the trustees from surplus * * *." (Italics supplied.)

That statement of fact is amply supported by the Tax Court's findings in that case. The policy provisions under which those payments were made, set out in the Tax Court's findings (quoted in 92 F. (2d) 962 at p. 966) provide:

"The income under Option A or the income during the instalments-certain period under Option B or C, after the first year, will be increased annually by such surplus as may be awarded by the Board of Trustees." (Italics supplied.)

But in the instant proceeding there is not a single finding of fact that can support the Tax Court's decision that the excess interest dividends here involved constituted "surplus * * * awarded by the Board." On the contrary, the Tax Court's findings in the instant case show that this petitioner's promise to pay excess interest was not conditioned upon the existence of any surplus or profits (R. 70, 72, 74) and the payment of this excess interest therefore cannot be deemed to be "surplus * * * awarded by the Board."

Furthermore the Tax Court's erroneous conclusion that the payment of these excess interest dividends constituted a distribution of surplus is directly contrary to

the express statutory provisions of Section 83 of the New York Insurance Law which was brought to the attention of the Tax Court.³

The decision below, not being supported by a single finding of fact, and being contrary to the findings made and to the provisions of a controlling state statute, is "not in accordance with law" and should be reversed. 44 Stat. 110, 26 U. S. C. Sec. 1141(c)(1); *Wilmington Trust Co. v. Helvering* (1942) 316 U. S. 164.

III.

The Tax Court's decision should not be affirmed because of failure of proof, a ground not stated by the Tax Court, since the stipulated facts would be ample to sustain a contrary decision as to all the payments involved.

As to no part of the deduction is the decision below unquestionably correct. As to the entire deduction that decision was expressly based upon the Tax Court's erroneous conclusion (R. 83) that the facts here involved "are substantially the same as the facts involved in *Penn Mutual Life Insurance Co. v. Commissioner, supra*."

The Tax Court not having properly determined that any part of the deduction should be disallowed, its decision should not be affirmed on the ground, *not stated by the Tax Court*, that the stipulated facts do not show the proportionate amounts respectively paid under various component groups of contracts. *Upon a proper determination, the showing of these proportionate amounts may not be necessary.*

³ This statute which is set out as an appendix to Petitioner's Reply Brief filed with this Court, was brought to the attention of the Tax Court in paragraph 45 of Petitioner's Proposed Findings of Fact and on pages 108, 124 and 125 of the Brief for Petitioner filed with that court.

If the Tax Court had not proceeded upon an erroneous conclusion it might have decided in favor of the petitioner on the entire deduction claimed. The Tax Court did not base its decision upon any failure of proof, and from the opinion of this Court, filed herein, it is clear that the Tax Court had power to make all the ultimate findings necessary to support the entire deduction. From the opinion of this Court it is clear that if the Tax Court had allowed the entire deduction upon the basis of the stipulated facts and of matters of common knowledge, of which that court might have taken judicial notice, that decision in favor of the petitioner would have been sustained by this Court.

As to the excess interest dividends paid to beneficiaries who had power to withdraw their funds, i. e., paid under *options elected by the beneficiaries*; the Tax Court's findings *without further inference* would seem to require the allowance of the deduction (R. 72, 73, 74).

As to the balance of the excess interest dividends paid, i. e., *those paid under options exercised by the insured*, the opinion of this Court shows that the Tax Court could have determined not only, (1) that the petitioner was definitely obligated to make the payments as "interest" under the *new* contracts issued after the specific excess rate had been declared; but also (2) that under the *old* contracts issued in prior years, the petitioner's original promise to pay excess interest dividends, though conditional, was a promise to pay "interest." If the Tax Court had made each of these two determinations, the stipulations and the findings of fact would be sufficient to sustain the deductions, for they show the exact amounts of excess interest dividends paid under each option elected by the insured under the combined *new* and *old* contracts (R. 73, 122).

Prayer.

Wherefore, petitioner prays that this its petition for a rehearing may be granted; and that upon consideration, this Court may vacate its opinion and judgment entered herein on March 27, 1944, and enter a new order correcting the opinion, reversing the decision below, and remanding the case to the Tax Court of the United States with instructions to make whatever further and appropriate findings that court may deem proper and to render a decision not inconsistent with the opinion of this Court and the findings already made; and that this Court may grant such further relief as may appear proper in the premises.

Respectfully submitted,

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES
By JOHN L. GRANT
Its Attorney
393 Seventh Avenue
New York 1, N. Y.

CERTIFICATE OF COUNSEL

The undersigned, counsel for petitioner herein, hereby certifies that the foregoing petition for a rehearing is presented in good faith and not for delay.

JOHN L. GRANT,
Counsel for Petitioner.

SUPREME COURT OF THE UNITED STATES.

No. 492.—OCTOBER TERM, 1943.

The Equitable Life Assurance Society
of the United States, Petitioner,
vs.
Commissioner of Internal Revenue. On Writ of Certiorari to
the United States Cir-
cuit Court of Appeals
for the Second Circuit.

[March 27, 1944.]

Mr. Justice DOUGLAS delivered the opinion of the Court.

The question in this case is whether petitioner, a mutual life insurance company, was entitled to deduct from its gross income for 1933 "excess interest dividends," paid within that year. The deduction was authorized if the amounts were "interest" paid on "indebtedness" within the meaning of § 203(a)(8) of the Revenue Act of 1932, 47 Stat. 169, 225. The Tax Court denied the deduction. 44 B. T. A. 293. The Circuit Court of Appeals affirmed. 137 F. 2d 623. The case is here on a petition for a writ of certiorari which we granted because the decision below and *Penn Mutual Life Ins. Co. v. Commissioner*, 92 F. 2d 962, from the Third Circuit conflicted with *Commissioner v. Lafayette Life Ins. Co.*, 67 F. 2d 209, from the Seventh.

The facts are stipulated and show the following: During and prior to 1933 petitioner issued life insurance policies which gave to the insured (and in some cases to the beneficiary) the right to have petitioner hold the face amount of the policies upon their maturity under one or more of several optional modes of settlement in lieu of payment in a lump sum. These optional modes of settlement are exercised under supplementary contracts. Thus one form of supplementary contract provides that the amount of the policy shall be left on deposit with petitioner. And it is provided in case of this, as well as the other types of supplementary

¹ This provision of the Act reads in part as follows: "In the case of a life insurance company the term 'net income' means the gross income less all interest paid or accrued within the taxable year on its indebtedness" with exceptions not relevant here.

contracts which are involved," that "if in any year the Society declares" that funds held under these options shall receive interest in excess of 3% per annum, the payments under them "shall be increased for that year by an Excess Interest Dividend as determined and apportioned by the Society." During the year 1933 some \$534,000 of excess interest dividends was paid by petitioner under these supplementary contracts. The amount so paid accrued during the year at the rate which had been declared by petitioner's board of directors at the beginning of that year.

Petitioner's argument runs as follows: Nothing in the supplementary contracts or underlying policies conditions the payment of excess interest dividends on the existence of a surplus. The policies and the statutes authorizing their issuance negative the idea that the payment of these excess interest dividends constitute a distribution of surplus or of earnings of prior years. Petitioner's declaration at the beginning of 1933 that it would pay excess interest dividends in that year at a specific rate constituted an offer. Those who elected in 1933 to keep the funds on deposit rather than to withdraw the amounts of the policies which had become payable during the year, accepted that offer. It is reasonable to assume that but for the declaration at the beginning of the year the new supplementary contracts would not have been made. In at least some of the cases where the funds were already on deposit at the beginning of 1933 the beneficiaries could have withdrawn them on demand. By refusing to exercise that right and by leaving the funds on deposit the beneficiaries accepted petitioner's offer. And it is again asserted, but for the declaration of excess interest dividends, it is reasonable to assume that petitioner would not have been permitted to retain and use those funds during that year. As to funds on deposit at the beginning of 1933 and over which the beneficiaries had no power of withdrawal, the argument is that the original promise to pay the excess interest dividends, though conditional, was a promise to pay "interest".²

While these are interesting questions which are propounded, the facts on which most of them turn were not determined by the Tax

² The other types of optional settlements involved here are instalment options for a fixed period and instalment options in a fixed amount.

³ The amount of funds in each of these three categories does not appear, though petitioner has offered its rough estimates.

Court. Its findings of fact did not go beyond the stipulation. And it apparently was not asked to go farther. It based its ruling on *Penn. Mutual Life Ins. Co. v. Commissioner, supra*. It may be that custom or a course of dealing or other circumstances would warrant findings of fact which would support at least part of the claimed deduction. But more proof is needed than the provisions of the policies and the contents of the stipulation. It is not our task to draw inferences from facts or to supplement stipulated facts. That function rests with the Tax Court. We may modify or reverse the decision of the Tax Court only if it is not in accordance with law. 44 Stat. 110, 26 U. S. C. § 1141 (1). *Wilmington Trust Co. v. Helvering*, 316 U. S. 164; *Dohson v. Commissioner*, 320 U. S. 489. We must make our determination on the record before us. If relevant evidence was offered before the Tax Court but rejected by it, we could remand the case to it for appropriate findings. But no such situation is presented here. Accordingly we can reverse the judgment below only if we can say on the basis of the provisions of policies and the meager stipulation that the excess interest dividends were "interest" within the meaning of the Act as a matter of law.

The "usual import" of the word interest is "the amount which one has contracted to pay for the use of borrowed money." *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 560; *Deputy v. DuPont*, 308 U. S. 488, 498. We cannot say as a matter of law that the excess interest dividends fall within that category. They appear to be amounts which may be declared or withheld at the pleasure of the board of directors. An obligation to pay may of course arise after the declaration, the same as in case of dividends on stock. But an obligation to pay declared dividends on stock would hardly qualify as "interest" within the meaning of the Act. The analogy of course is not perfect, as these excess interest dividends may not be payable from surplus or earnings of prior years and the obligation to pay the principal amount under each option was absolute. Yet payments made wholly at the dis-

* See 163(a) of the Revenue Act of 1942, 56 Stat. 798, 808, includes within the definition of "interest paid" the following: "All amounts in the nature of interest, whether or not guaranteed, paid within the taxable year on insurance or annuity contracts or contracts arising out of insurance or annuity contracts, which do not involve, at the time of payment, life, health, or accident contingencies." The Senate Report points out that this provision was designed to include both guaranteed interest and excess interest dividends. S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 146-147.

4 *Equitable Life Assur. Soc. of United States vs. Commissioner.*

cretion of the company have a degree of contingency which the notion of "interest" ordinarily lacks. If we expanded the meaning of the term to include these excess interest dividends, we would indeed relax the strict rule of construction which has obtained in case of deductions under the various Revenue Acts. *New Colonial Co. v. Helvering*, 292 U. S. 435, 440; *Deputy v. Duport*, *supra*, p. 493. Appropriate findings of fact might well bring such payments within the meaning of "interest", as for example a finding that their declaration was the basis on which new contractual engagements were made. But such is not this case.

Affirmed.